
Review of the Financial Plan of the City of New York

Report 2-2018



OFFICE OF THE NEW YORK STATE COMPTROLLER

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Message from the Comptroller

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As the State's chief financial officer, I have a constitutional and statutory responsibility to monitor the finances of the City of New York.

This report discusses the economic, fiscal and social challenges facing New York City in an effort to promote an informed discussion. I encourage every City stakeholder to learn more about these issues and to participate fully in the public debate.

Thomas P. DiNapoli
State Comptroller



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I. Executive Summary

On April 26, 2017, the Mayor released his proposed budget for FY 2018 and the associated financial plan (“the April Plan”) covering fiscal years 2017 through 2021 (see Figure 1). The April Plan incorporates changes since the FY 2017 budget was adopted in June 2016.

The City now projects a surplus of \$3.7 billion in FY 2017. The surplus was generated from reserves (\$2.2 billion) and a citywide savings program (\$1.5 billion). The April Plan assumes that the City will transfer the surplus to FY 2018, balancing that year’s budget.

Although the FY 2018 budget is balanced, the out-year budget gaps have grown since the start of the fiscal year. The gaps for fiscal years 2019 and 2020 have each grown by \$650 million, in part because the City has increased its reserves in those years, but mostly because tax revenues are expected to be lower than previously projected. The FY 2021 budget gap has increased by \$500 million since January 2017.

The City now projects budget gaps of \$3.6 billion in FY 2019, \$3 billion in FY 2020 and \$2.3 billion in FY 2021. The gaps are still relatively small as a share of City fund revenues (averaging 4.4 percent). In addition, the budgets for these years include annual reserves of \$1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

In recent years, the surplus has been driven by unanticipated nonproperty tax collections. Collections were higher by \$1.4 billion in FY 2013 and by about \$2.4 billion in each of fiscal years 2014 and 2015, offsetting the budgetary impact of unplanned spending and helping to balance the following year’s budget.

Last year, nonproperty tax collections were higher by just \$362 million and accounted for only a small share of the \$4 billion surplus. In FY 2017, the City expects nonproperty tax collections to be lower by \$712 million compared to its June 2016 forecast.

If nonproperty tax collections continue to disappoint, closing the out-year budget gaps could be more challenging, especially if the City also has to address unplanned spending or cuts in federal aid. If federal aid were reduced, the City would come under pressure to offset the impact with its own funds rather than allowing vital services to be cut.

The April Plan assumes the receipt of \$7.8 billion in federal aid in FY 2018, representing more than 9 percent of the operating budget. However, these estimates exclude most federal Medicaid funds, which do not flow through the City’s budget. The Office of the State Comptroller (OSC) estimates that the federal share of Medicaid in New York City exceeds \$18 billion.

There are also a number of public authorities that have a close financial relationship with the City, including the Health and Hospitals Corporation, the New York City Housing Authority and the Metropolitan Transportation Authority. Cuts in federal funding to these agencies could require the City to increase its financial assistance.

In total, federal aid approaches \$33 billion when the amounts in the City’s operating and capital budgets are combined with Medicaid and the budgets of these public authorities. (The share that directly affects the City’s operating budget totals \$7.8 billion in FY 2018.)

On May 4, 2017, the House of Representatives approved the American Health Care Act (AHCA). Beginning in 2020, the AHCA would eliminate the enhanced Medicaid reimbursement rate for certain new enrollees, reduce health insurance subsidies and cap federal Medicaid funding to the states. The Congressional Budget Office estimates that the AHCA would cut federal Medicaid funding to the states by \$834 billion over 10 years compared to current law.

The Governor has estimated that the AHCA would cost New York State \$4.7 billion over four years. An estimated 1.1 million City residents would be at risk of losing Medicaid coverage, and another 460,000 could lose coverage through insurance plans offered by the State's health insurance exchange. The AHCA would also reduce Medicaid funding to the State by the amount that counties outside of New York City are required to contribute to the cost of Medicaid, bringing the total cost to \$6.9 billion.

OSC estimates that New York City would lose \$305 million annually beginning in 2020 from the elimination of the enhanced federal Medicaid reimbursement rate for new enrollees to states that expanded Medicaid eligibility. The provision requires states to share the additional federal Medicaid funding with localities, such as New York City, that contribute to the cost of Medicaid.

The U.S. Senate may modify the House bill, pass its own bill, or fail to reach a consensus. Any legislation that reduces Medicaid eligibility or reduces Medicaid funding could impact the State's budget, which could affect the City's fiscal relationship with the State.

The impact of the federal budget may not be known for some time. Congress approved a spending plan that will fund the federal government through September 30, 2017. The President's proposed budget for the federal fiscal year 2018, which begins on October 1, 2017, focuses heavily on cuts to social safety net programs and discretionary spending.

While job growth has slowed in the City as the labor market has tightened, the economy remains strong. The City added 630,000 jobs between 2009 and 2016 (the largest job expansion in its history) and the unemployment rate has fallen to 4 percent (the lowest level in the past 40 years). The City is on pace to add 59,000 jobs in 2017, half the average of the past three years.

Despite the strength of the local economy, tax collections have weakened. Collections grew by 3.2 percent in FY 2016, less than half the average gain during fiscal years 2011 through 2015. Tax collections are projected to slow to 2.3 percent in the current fiscal year and increase by a modest 3 percent in FY 2018.

OSC has identified budget risks totaling \$98 million in FY 2017, mostly from continued weakness in business tax collections (see Figure 2). However, the April Plan includes a general reserve of \$300 million, which would more than offset this risk. A number of budget risks in subsequent years, including the potential for lower nonproperty tax collections, could increase the size of the projected budget gaps.

The Health and Hospitals Corporation continues to face serious financial challenges. Changes in the health care law currently being contemplated at the federal level would further complicate the Corporation's financial outlook.

While the City faces budget risks, the general reserve stands at \$1 billion annually beginning in FY 2018, and the City has set aside \$250 million annually in its Capital Stabilization Reserve. It has also replenished the Retiree Health Benefits Trust, which now has a balance of \$4 billion.

The City has also resumed the process of identifying opportunities for savings. The April Plan includes actions that have increased the cumulative value of the citywide savings program to \$6.1 billion during fiscal years 2017 through 2021.

In conclusion, the greatest risks facing the City's budget are the potential for federal budget cuts and the repeal of the Affordable Care Act. However, it may be some time before the magnitude of these problems comes into focus. In the meantime, the City should continue to increase its reserves, which will provide a cushion against any adverse development.

FIGURE 1
New York City Financial Plan
(in millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues					
Taxes					
General Property Tax	\$ 24,402	\$ 25,629	\$ 27,292	\$ 28,618	\$ 29,929
Other Taxes	29,193	29,989	31,237	32,453	33,685
Tax Audit Revenue	1,251	850	721	721	721
Subtotal: Taxes	\$ 54,846	\$ 56,468	\$ 59,250	\$ 61,792	\$ 64,335
Miscellaneous Revenues	7,011	6,480	6,640	6,854	6,841
Unrestricted Intergovernmental Aid	57	---	---	---	---
Less: Intra-City Revenue	(2,065)	(1,815)	(1,737)	(1,739)	(1,744)
Disallowances Against Categorical Grants	613	(15)	(15)	(15)	(15)
Subtotal: City Funds	\$ 60,462	\$ 61,118	\$ 64,138	\$ 66,892	\$ 69,417
Other Categorical Grants	976	880	868	859	856
Inter-Fund Revenues	641	667	662	599	597
Federal Categorical Grants	8,937	7,799	7,002	6,897	6,879
State Categorical Grants	14,437	14,396	14,849	15,347	15,702
Total Revenues	\$ 85,453	\$ 84,860	\$ 87,519	\$ 90,594	\$ 93,451
Expenditures					
Personal Service					
Salaries and Wages	\$ 25,759	\$ 27,306	\$ 28,625	\$ 29,425	\$ 30,064
Pensions	9,395	9,572	9,866	9,936	10,001
Fringe Benefits	9,456	10,119	10,795	11,694	12,483
Subtotal: Personal Service	\$ 44,610	\$ 46,997	\$ 49,286	\$ 51,055	\$ 52,548
Other Than Personal Service					
Medical Assistance	5,915	5,915	5,915	5,915	5,915
Public Assistance	1,584	1,594	1,605	1,617	1,617
All Other	29,138	28,118	27,565	27,571	27,789
Subtotal: Other Than Personal Service	\$ 36,637	\$ 35,627	\$ 35,085	\$ 35,103	\$ 35,321
Debt Service	6,282	6,528	7,225	7,908	8,396
FY 2016 Budget Stabilization & Discretionary Transfers	(4,038)	---	---	---	---
FY 2017 Budget Stabilization	3,727	(3,727)	---	---	---
Capital Stabilization Reserve	---	250	250	250	250
General Reserve	300	1,000	1,000	1,000	1,000
Subtotal	\$ 87,518	\$ 86,675	\$ 92,846	\$ 95,316	\$ 97,515
Less: Intra-City Expenses	(2,065)	(1,815)	(1,737)	(1,739)	(1,744)
Total Expenditures	\$ 85,453	\$ 84,860	\$ 91,109	\$ 93,577	\$ 95,771
Gap to be Closed	\$ ---	\$ ---	\$ (3,590)	\$ (2,983)	\$ (2,320)

Source: NYC Office of Management and Budget

FIGURE 2
OSC Risk Assessment of the New York City
Financial Plan
(in millions)

	<i>Better/(Worse)</i>				
	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Surplus/(Gaps) Per NYC Financial Plan	\$ ---	\$ ---	\$ (3,590)	\$ (2,983)	\$ (2,320)
Tax Revenues	(150)	(200)	(200)	(200)	(200)
Special Education Medicaid Reimbursement	(23)	(79)	(79)	(79)	(79)
Health and Hospitals Corporation	---	(164)	(164)	(164)	(164)
Uniformed Agency Overtime	---	(125)	(125)	(125)	(125)
Homeless Shelters	---	(112)	(112)	(112)	(112)
Sales Tax Asset Receivable Corporation	---	(50)	(150)	---	---
Sale of Taxi Medallions	---	---	(107)	(257)	(367)
Revenue from Development Opportunities	---	---	---	(100)	---
Miscellaneous Revenues	75	75	75	75	75
Debt Service	---	125	---	---	---
OSC Risk Assessment	(98)	(530)	(862)	(962)	(972)
Potential Surplus/(Gaps) Per OSC¹	\$ (98)	\$ (530)	\$ (4,452)	\$ (3,945)	\$ (3,292)

¹ The April Plan includes a general reserve of \$300 million in FY 2017 and \$1 billion in each of fiscal years 2018 through 2021, which, if not needed, could be used to help close the projected budget gaps. In addition, the Capital Stabilization Reserve has a

balance of \$250 million in each of fiscal years 2018 through 2021, and the Retiree Health Benefits Trust, which the City has used in the past as a rainy-day fund, has a balance of \$4 billion.

II. Economic Trends

New York City's economy remains strong, but job growth has slowed over the past 18 months as the labor market has tightened. The City is on pace to add 59,000 jobs in 2017, about half the average of the past three years. Potential changes in federal fiscal and monetary policies, health care and financial deregulation could have a significant impact on the City's economy.

The National Economy

Between 2010 and 2016, the nation added 13.9 million jobs (nearly double the number lost during the Great Recession). While job growth remains solid, it slowed to an annual rate of 1.5 percent during the first four months of 2017. Employment reached a record 146.1 million jobs in April 2017.

The unemployment rate has declined to 4.4 percent, the lowest in 10 years, and initial claims for unemployment insurance are at the lowest levels since the 1970s. A broader measure of unemployment that includes those who have stopped looking for work and those in part-time jobs who want full-time positions has dropped to 8.6 percent, the lowest level since November 2007.

The nation's gross domestic product (GDP) grew by only 1.6 percent in 2016, which was one of the slowest years during the recovery. Although GDP grew at an annual rate of only 0.7 percent during the first quarter of 2017, the April Plan and most economists expect growth to pick up and average 2.3 percent for the full year.

After keeping interest rates near zero for seven years to help support the economy, the Federal Reserve began to increase short-term interest rates in December 2015. Since then, the Fed has raised rates two additional times (December 2016 and March 2017) and has indicated it will raise rates further. The Fed is also considering when and how to reduce its balance sheet, which quadrupled to more than \$4 trillion during the recession.

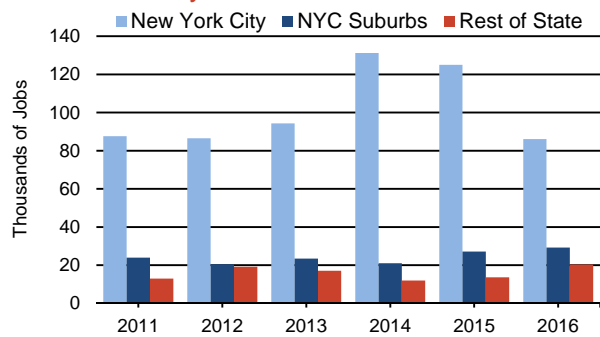
New York State

Between 2009 and 2016, New York State added 855,900 jobs (three and a half times the number lost during the recession). More than 90 percent of the jobs were added in the downstate region (i.e., New York City, Long Island, and Westchester, Rockland and Orange counties). The State's unemployment rate has fallen from the recessionary peak of 8.9 percent to 4.3 percent, close to the national rate and the State's prerecession level.

Every March, the New York State Department of Labor releases revised employment data for the most recent two years. The revised figures show that statewide job growth slowed to 136,000 jobs in 2016, compared to an average of 165,000 during the two prior years.

While job growth slowed in New York City during the past two years (see Figure 3), it picked up in the City's suburbs and in the rest of the State. The State Department of Labor initially reported that job growth had come to a virtual halt outside of the City and its suburbs, but the revised figures show that the rest of the State added 20,400 jobs in 2016, about 50 percent more than in 2015. Nonetheless, growth remained sluggish, increasing by 0.7 percent.

FIGURE 3
Job Growth Concentrated in
New York City and Its Suburbs



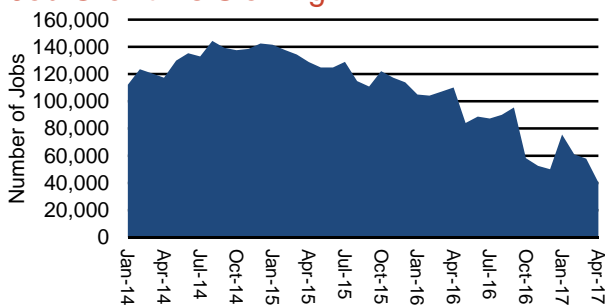
Sources: NYS Department of Labor; OSC analysis

New York City

New York City is experiencing the largest job expansion in the post–World War II period. Between 2009 and 2016, 630,000 jobs were added (six times the amount lost during the recession). Employment reached a record of nearly 4.4 million jobs in April 2017.

However, job growth has been slowing (see Figure 4). So far this year, employment has been growing at an annualized pace of 59,000 jobs, about half the average of the past three years. The April Plan assumes job growth will slow even further as the year progresses, with the City adding 53,000 jobs in 2017.

FIGURE 4
Job Growth is Slowing



Note: Change is from same month one year earlier.
Sources: NYS Department of Labor; OSC analysis

Job growth has slowed as the labor market has tightened. The City’s unemployment rate was 4 percent in March 2017, the lowest rate since the current data series began in January 1976, and lower than the national and State unemployment rates. (The unemployment rate was 4.1 percent in April 2017.) However, unemployment rates vary across neighborhoods and demographic groups.

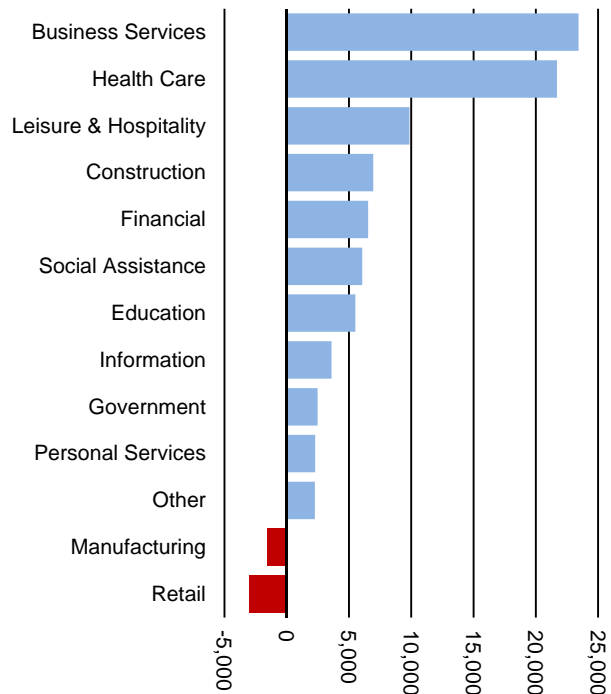
A broader measure of unemployment that includes those who have stopped looking for work and those in part-time jobs who want full-time positions has dropped to 8.3 percent in the

first quarter of 2017, which was lower than in the first quarter of 2007, before the recession.

Despite the rapid rise in employment, wage growth has been weak. The April Plan assumes that the growth in average salaries will accelerate from 1.1 percent in 2016 to 2.8 percent in 2017 as the record-low unemployment rate puts pressure on employers to pay higher salaries to fill vacancies. An increase in the minimum wage is another factor that will contribute to wage growth.

Job growth since 2009 has been driven by business services, health care, and the leisure and hospitality sectors. Business services has been the largest contributor, adding nearly a quarter of the jobs during the last seven years. Growth was strong in 2016, with the sector adding 23,400 jobs (see Figure 5), but growth slowed in April 2017.

FIGURE 5
New York City Job Growth by Sector in 2016



Sources: NYS Department of Labor; OSC analysis

The health care sector accounted for nearly 15 percent of the jobs added during the recovery. The sector added jobs even during the recession, and the pace of growth has nearly doubled since 2010 to reach a gain of 21,700 jobs in 2016. Strong growth continued during the first four months of 2017.

Health care now provides nearly 500,000 jobs in the City's hospitals, doctors' offices, clinics and home health care agencies. Potential federal changes to health care, including cuts in Medicaid funding, could significantly impact both services and jobs in New York City.

The leisure and hospitality sector accounted for about one-fifth of the jobs added during the past seven years, though job growth in the sector slowed sharply in 2016, with weakness in both restaurants and hotels. Last year, the sector added 9,800 jobs, half the rate in the prior year, and growth has continued to slow in 2017.

The construction sector added 7,000 jobs in 2016, bringing total employment to a record 146,250 jobs. The industry is on pace to add less than half as many jobs (2,800) in 2017.

The retail sector in New York City, as in the nation, is undergoing fundamental changes as consumers have shifted to purchasing more items online. Several large chains have closed stores or declared bankruptcy, and pressure on the sector is likely to continue. Last year, the City's retail sector lost over 3,000 jobs (after contributing more than 10,000 jobs annually between 2009 and 2014). During the first four months of 2017, retail employment was flat.

Despite recent declines in retail employment, consumer sentiment (a measure of consumer confidence and buying intentions) in New York City reached the highest level of the current economic expansion in March 2017, according to the Siena College Research Institute.

Securities Industry

The securities industry is an important part of the City's economy. Even though it accounts for only 5 percent of the private sector jobs, it is responsible for more than one-fifth of private sector wages. The industry added jobs over the past three years (2,800 jobs in 2014, 4,500 jobs in 2015 and 3,700 jobs in 2016), but it is still 6 percent smaller than before the financial crisis.

The pretax profits for the broker/dealer operations of New York Stock Exchange member firms (the traditional measure of securities industry profitability) increased by 21 percent in 2016 to \$17.3 billion, reversing a three-year trend of declining profits. Profits were driven by cost-cutting and lower noncompensation expenses (which include the costs of legal settlements). Noncompensation expenses declined for the second consecutive year, by nearly \$3.8 billion in 2016.

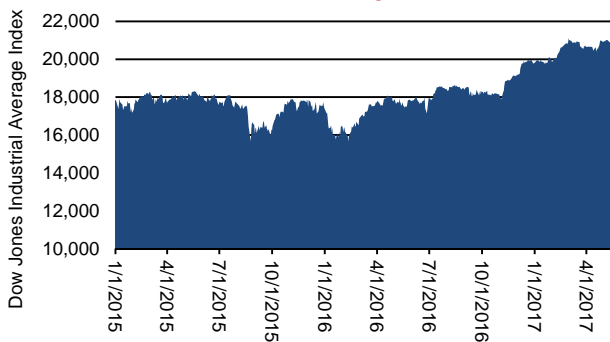
Despite sharply higher profits in 2016, OSC estimates that the average bonus paid to securities industry employees in New York City increased by only 1 percent to \$138,210 (the first increase in three years).

The April Plan assumes that securities industry profits will decline by 10 percent in 2017. Although first-quarter results for the securities industry are not yet available, the nation's six largest financial firms demonstrated strong first-quarter results, which bodes well for the securities industry.

Profitability could be impacted by changes in public policies. The President has indicated that he supports lowering the corporate tax rate and reducing regulations for the financial sector. While fewer regulations could boost profits, it could also lead to greater risk-taking and increased volatility. Brexit could benefit the sector if some London firms move operations to New York City.

The financial markets surged after the presidential election (see Figure 6). The Dow Jones Industrial Average rose by 13.5 percent between November 8, 2016, and May 19, 2017, providing a boost to trading revenues at Wall Street firms, generating new capital gains for taxpayers, and boosting returns for the City and State pension systems.

FIGURE 6
Dow Jones Industrial Average



Sources: S&P Dow Jones Indices; OSC analysis

Tourism

Tourism is an important part of the City’s economy. The number of visitors to New York City reached a record 60.7 million in 2016. According to NYC & Company, the official tourism and marketing organization of New York City, the number of visitors is expected to set another record in 2017 with 61.7 million visitors.

The President’s executive orders restricting travel from several largely Muslim nations has discouraged overseas visitors. As a result, NYC & Company predicts that 300,000 fewer international visitors will travel to New York City in 2017, the first decline in seven years.

Since foreign tourists spend about four times as much as domestic visitors, the decline in international travelers could reduce spending by an estimated \$600 million, which could translate into \$120 million less in tax revenue for the City and State, according to NYC & Company.

Commercial Real Estate

The commercial real estate market remains strong, as building values have risen sharply in recent years. Demand, driven by rising office employment, has boosted leasing activity since the recession, lowering the vacancy rate and raising rental rates. It has also encouraged the development of new properties. According to Jones Lang LaSalle, more than 11 million square feet of office space will enter the market by 2020.

Vacancy rates began to edge up to 10.1 percent in 2016 as new inventory came on the market faster than it could be absorbed. Overall rental rates continue to increase. The use of concessions appears to be increasing as older inventory competes with newer construction.

The rise in the value of buildings has increased the appeal of the City’s real estate market for investors. The number of commercial transactions rose sharply between 2009 and 2015, helping to boost revenues from the City’s transaction taxes. In 2016, however, the number of transactions declined by 27 percent.

III. Changes Since the Beginning of the Fiscal Year

The April Plan incorporates a number of changes since the FY 2017 budget was adopted in June 2016 (see Figure 8, next page). The City now projects a surplus of \$3.7 billion in FY 2017, driven by a drawdown in unneeded reserves (\$2.2 billion) and a citywide savings program (\$1.5 billion). Unplanned revenues will offset unplanned spending for the year.

The budget gap for FY 2018 increased by nearly \$1 billion to \$3.7 billion, but the budget will be balanced by transferring the FY 2017 surplus to FY 2018. The budget gaps for fiscal years 2019 and 2020 have increased by a net of about \$650 million annually since June 2016, in part because the City increased its reserves in those years, but mostly because tax collections are expected to be lower than previously projected. New agency needs were more than offset by savings from the citywide savings program.

The April Plan projects budget gaps of \$3.6 billion in FY 2019, \$3 billion in FY 2020 and \$2.3 billion in FY 2021. The gaps are relatively small as a share of City fund revenues (averaging 4.4 percent). In addition, the budgets for these years include annual reserves of \$1.25 billion. If not needed, the reserves could be used to narrow the projected gaps.

City fund revenues are projected to be higher by \$523 million in FY 2017, driven by unanticipated audit payments (\$537 million). While property tax collections were also higher, nonproperty taxes (e.g., real estate transaction, sales and business taxes) were lower by \$712 million. The City also lowered its forecast of City fund revenues for fiscal years 2018 through 2020 because of another delay in the sale of taxi medallions and continued weakness in nonproperty taxes.

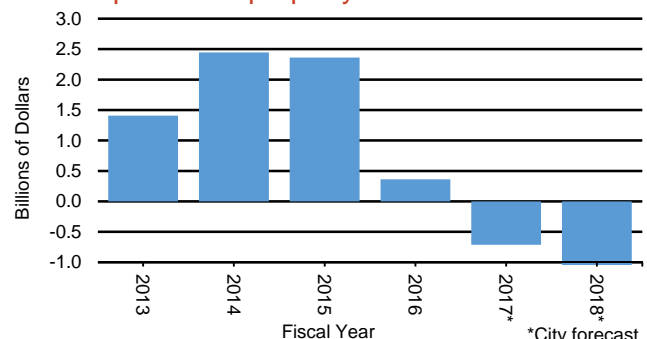
City-funded spending is expected to be higher by a net of \$559 million in FY 2017 and by a cumulative total of \$4 billion through FY 2020. Nearly all of the increase comes from agency needs, mainly for homeless services and new education initiatives.

Since the beginning of FY 2017, the City has freed up \$2.2 billion in reserves. It drew down the general reserve by \$700 million and the capital stabilization reserve by \$500 million. The City will also benefit by \$628 million from a reduction in the reserve for disallowances and by forgoing a planned contribution to the reserve. It also anticipates savings of \$400 million from overestimating prior years' expenses. The City is implementing a savings program that is expected to generate \$1.5 billion in FY 2017 and \$6.1 billion over five years (see Section VI for a detailed discussion).

In most years, the surplus has been driven by unanticipated nonproperty tax collections. For example, collections (excluding audits) exceeded the City's expectations by \$1.4 billion in FY 2013 and by about \$2.4 billion in each of fiscal years 2014 and 2015 (see Figure 7), helping to offset the impact of unplanned spending.

In FY 2016, nonproperty tax collections were higher by just \$362 million, accounting for only a small share of the \$4 billion surplus. Nonproperty tax collections are expected to be lower than initially forecast by \$712 million in FY 2017 and \$1.1 billion in FY 2018. If these collections continue to disappoint, closing the out-year budget gaps could be more challenging, especially if the City also has to address unplanned spending or cuts in federal aid.

FIGURE 7
Unanticipated Nonproperty Tax Collections



Note: Excludes audits.

Sources: NYC Office of Management and Budget; NYC Comptroller; OSC analysis

FIGURE 8
Financial Plan Reconciliation—City Funds
April 2017 Plan vs. June 2016 Plan
(in millions)

	<i>Better/(Worse)</i>			
	FY 2017	FY 2018	FY 2019	FY 2020
Projected Gaps Per June 2016 Plan	\$ ---	\$ (2,816)	\$ (2,945)	\$ (2,326)
Revenue Reestimate				
General Property Tax	377	219	372	427
Sales Tax	(122)	(188)	1	29
Business Taxes	(189)	(317)	(218)	(221)
Real Estate Transaction Taxes	(224)	(380)	(401)	(374)
Personal Income Tax (incl. School Tax Relief)	(267)	(231)	(231)	(145)
Other Taxes	90	13	4	(18)
Tax Audits	537	136	7	7
Subtotal: Taxes	202	(748)	(466)	(295)
All Other	321	(41)	(43)	76
Total	523	(789)	(509)	(219)
Citywide Savings Program				
Agency Actions	1,240	843	875	931
Debt Service	295	421	232	207
Total	1,535	1,264	1,107	1,138
Reserves				
General Reserve	700	---	---	---
Capital Stabilization Reserve	500	(250)	(250)	(250)
Prior-Year Payable	400	---	---	---
Disallowances of Federal and State Aid	628	---	---	---
Total	2,228	(250)	(250)	(250)
New Needs				
Department of Homeless Services	(204)	(256)	(264)	(271)
Department of Education	(94)	(148)	(175)	(221)
Uniformed Agencies	(78)	(184)	(145)	(191)
Other Health and Social Services	(21)	(141)	(122)	(138)
Pension Contributions	27	138	(14)	(154)
All Other	(155)	(477)	(205)	(283)
Total	(525)	(1,068)	(925)	(1,258)
Enacted State Budget Impact	(34)	(68)	(68)	(68)
Net Change During FY 2017	3,727	(911)	(645)	(657)
Surplus/(Gap)	\$ 3,727	\$ (3,727)	\$ (3,590)	\$ (2,983)
Surplus Transfer	(3,727)	3,727	---	---
Projected Gaps Per April 2017 Plan	\$ ---	\$ ---	\$ (3,590)	\$ (2,983)

Sources: NYC Office of Management and Budget; OSC analysis

IV. Impact of the State Budget

On April 9, 2017, the State Legislature completed action on a budget for State fiscal year (SFY) 2017-2018, which began on April 1, 2017. The budget increases education aid to New York City by \$387 million in FY 2018. While this was \$155 million less than the amount assumed in the City's January Plan, the shortfall had no impact on existing programs.

As discussed below, the State budget includes three actions that the City estimates will increase its costs by \$34 million in FY 2017 and by \$68 million annually in subsequent years.

- State reimbursement for foster care was reduced by \$22 million in FY 2017 and by \$44 million annually thereafter, including State tuition payments for special education students in foster care attending private schools.
- A reduction in State support for students in private special education settings will increase the City's costs by an estimated \$10 million in FY 2017 and \$20 million annually thereafter.
- A reduction in State funding for child care will increase the City's costs by \$2 million in FY 2017 and by \$4 million annually thereafter.

The State increased funding for charter schools for the upcoming school year, but the State budget requires future increases to be paid by the City.

The State approved the Affordable New York Housing Program, which replaces the expired 421-a tax abatement program. The new program provides real estate developers in New York City with property tax abatements for up to 35 years based on the number of affordable units created and whether they meet certain construction wage requirements. The program is not expected to adversely impact the City's budget during the current five-year financial plan period, but it could reduce property tax collections in future years by more than the amounts anticipated under the expired program.

The State raised the age of criminal responsibility for most crimes from 16 years to 17 years, effective on October 1, 2018, and to 18 years, effective on October 1, 2019. New York has been one of only two states that automatically process 16- and 17-year-olds as adults in the criminal justice system.

When the new law takes effect, those accused of misdemeanors will have their cases handled by the family court. Those accused of felonies will have their cases handled by a new section of the criminal court (defendants could have their cases transferred to family court if they meet certain criteria). Juveniles will no longer be held in adult facilities or jails, but instead will be placed in juvenile justice facilities and be provided with additional services.

The City has not yet made an estimate of the potential impact of raising the age of criminal responsibility, which could affect its financial plan beginning in FY 2019. The City would be required to contribute to the cost unless the State waives the local share (which would be based on proof of financial hardship).

The State has appropriated \$2.5 billion for the creation and preservation of 100,000 affordable and 6,000 supportive housing units statewide. Funding for New York City will include, but not be limited to, \$200 million for the New York City Housing Authority and \$100 million for the development of affordable housing for low-income households.

The enacted State budget establishes the Clean Water Infrastructure Act at \$2.5 billion. Of that amount, \$200 million has been set aside for New York City. The City will be eligible to apply for some of the remaining \$2.3 billion in funding.

The impact of the Governor's proposed budget on the Metropolitan Transportation Authority is discussed later in this report (see Section IX).

V. Federal Actions

New York City, like many jurisdictions across the nation, faces the potential loss of federal aid. If this were to occur, the City could come under pressure to make up for the shortfall with its own funds rather than allow vital services to be cut.

The City's budget assumes the receipt of \$7.8 billion in federal aid in FY 2018, representing more than 9 percent of the operating budget. More than two-thirds of the funding would be devoted to social services and education programs, with most of the balance going to housing and health programs.

However, these estimates exclude most federal Medicaid funds, which do not flow through the City's budget. Instead, doctors and hospitals are reimbursed directly for the services they provide to enrollees in the Medicaid program. OSC estimates that the federal share of Medicaid in New York City exceeds \$18 billion.²

In addition, a number of public authorities have a close financial relationship with the City, including the Health and Hospitals Corporation (HHC), the New York City Housing Authority (NYCHA) and the Metropolitan Transportation Authority (MTA). Cuts in federal funding to these agencies could require the City to increase its financial assistance.

The HHC is the largest municipal hospital system in the nation (serving 1.2 million patients annually) and is already in the midst of a financial crisis. Nearly half of its operating budget is funded with federal aid (\$3.3 billion).³

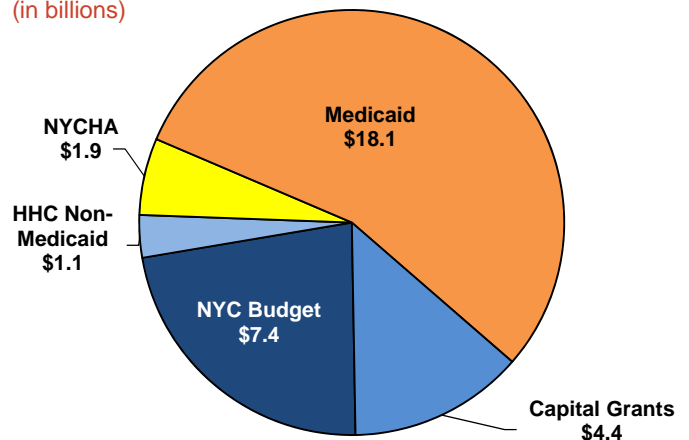
NYCHA is the largest housing authority in the nation, housing more than 400,000 residents. The nonrent portion of its operating budget is funded mostly by the federal government (\$1.9 billion). NYCHA's five-year \$4.3 billion capital program is also dependent on federal aid.

The MTA does not receive any operating budget assistance from the federal government, but it is dependent on federal grants to fund its five-year capital program. The 2015-2019 capital program (valued at \$29.6 billion) counts on the receipt of \$6.9 billion in federal funds, nearly one-quarter of the program's total value.⁴ The MTA expects an average of \$1.3 billion annually in federal capital grants during the capital plan period.

In addition, the MTA is counting on \$2 billion in federal grants to help fund the second phase of the Second Avenue Subway. The Gateway project, which would build a new two-track tunnel under the Hudson River connecting Manhattan and New Jersey, and would expand Pennsylvania Station, is also dependent on federal assistance.

In total, federal aid approaches \$33 billion (see Figure 9) when the amounts in the City's operating and capital budgets are combined with Medicaid and the budgets of these three public authorities. The share that directly affects the City's operating budget totals \$7.8 billion.

FIGURE 9
Federal Aid to New York City
(in billions)



Notes: NYC budget estimate adjusted to exclude \$365 million in federal Medicaid funding (mostly for administrative services), which is included in Medicaid. The HHC share of Medicaid is also included in the citywide total for Medicaid.

Sources: NYC Office of Management and Budget; OSC analysis

² Consolidated Schedule of Expenditures of Federal Awards, City of New York Single Audit Report for the fiscal year ending June 30, 2016.

³ Mostly federal funding for Medicaid and Medicare programs.

⁴ The City has agreed to contribute \$2.5 billion to the MTA's five-year capital program.

City residents also receive billions of dollars in direct federal assistance, such as Social Security, veteran's benefits, Pell grants and the Supplemental Nutrition Assistance Program. Although the City would be under no obligation to offset cuts in these programs, any cuts could increase the demand for City services. Many nonprofit organizations are also dependent on federal aid to fulfill their missions.

The impact of the federal budget may not be known for some time. Congress approved an omnibus spending plan that will fund the federal government through September 30, 2017. The President's proposed budget for the federal fiscal year 2018, which begins on October 1, 2017, focuses heavily on cuts to social safety net programs and nondefense discretionary spending. It is unlikely that Congress will approve the budget as proposed by the President.

The Affordable Care Act (ACA) increased the number of Americans with health insurance by expanding Medicaid eligibility and by offering subsidies to lower-income taxpayers who purchase health insurance through government-sponsored health insurance marketplaces.

The ACA prohibits insurance companies from denying insurance to people with preexisting conditions, requires all insurance plans to provide 10 essential benefits, and allows parents to keep their children on their health insurance plans until age 26 at no additional cost.

On March 6, 2017, the U.S. House of Representatives proposed the American Health Care Act of 2017 (also known as the AHCA). Beginning in 2020, the act would eliminate enhanced Medicaid funding for certain new enrollees, reduce health insurance subsidies, and cap federal Medicaid funding to the states.

On March 23, 2017, the Congressional Budget Office (CBO) estimated that 24 million Americans would lose health insurance by 2026 (including 14 million Medicaid enrollees) if the act were enacted into law as amended. Medicaid funding to the states would be cut by \$839 billion over 10 years compared to current law.

The Governor estimated that the AHCA would cost New York State \$4.7 billion over four years. An estimated 1.1 million City residents would be at risk of losing Medicaid coverage, and another 460,000 could lose coverage through insurance plans offered through the State's health insurance exchange.

OSC estimates that New York City would lose \$305 million annually beginning in 2020 from the elimination of the enhanced federal Medicaid reimbursement rate for new enrollees to states that expanded Medicaid eligibility. The provision requires states to share the additional federal Medicaid funding with localities, such as New York City, which contribute to the cost of Medicaid.

After two attempts, the House bill failed to obtain the support needed to bring it to a vote. In an effort to gain support, the bill was amended to permit states to request waivers from the mandates regarding preexisting conditions and essential benefits. The final bill would also reduce Medicaid funding to New York State by the amount that counties outside of New York City are required to contribute to the cost of Medicaid (nearly \$2.3 billion).

On May 4, 2017, the House approved the revised American Health Care Act of 2017 even though the CBO had not yet analyzed the final bill. The CBO subsequently estimated that 23 million Americans would lose health insurance by 2026 (including 14 million Medicaid enrollees). Medicaid funding to the states would be cut by \$834 billion over 10 years compared to current law, a cumulative reduction of 17 percent (and a nearly 25 percent reduction in 2026).

The U.S. Senate may modify the House bill, pass its own bill or fail to reach a consensus. Any legislation that reduces Medicaid eligibility or federal Medicaid funding could have an impact on the State budget, which could affect the City's fiscal relationship with the State. The City accounts for about 60 percent of the State's Medicaid costs.

The President's executive orders restricting travel from seven largely Muslim nations (later revised to exclude Iraq) has discouraged overseas visitors. As a result, NYC & Company predicts that 300,000 fewer international visitors will travel to New York City in 2017, which could cost the State and the City an estimated \$120 million in lost tax revenues.

The U.S. Attorney General has sent letters to New York City and other sanctuary cities informing local officials that he could withhold certain federal law enforcement grants (more than \$4 million to New York City) if they do not validate their compliance with Section 1373 of the U.S. Code, which prohibits interference with Immigration and Customs Enforcement. On April 25, 2017, a federal district court granted a preliminary injunction blocking enforcement of the executive order on the grounds that it violates the U.S. Constitution.

The President has outlined goals for federal tax reform. The proposed changes include reducing the business income tax rate from 35 percent to 15 percent; reducing the number of tax brackets for individuals from seven to three (35 percent, 25 percent and 10 percent); doubling the standard deduction; limiting itemized deductions to those associated with home ownership, charitable giving and retirement savings; and repealing the estate tax and alternative minimum tax.

Although the outline does not include sufficient detail to permit a comprehensive evaluation, the President's tax proposal would likely increase the federal budget deficit. Large tax cuts could stimulate the economy, but could also lead to unforeseen consequences. Eliminating or capping the exemption for municipal bonds could increase the City's borrowing costs.

The President has proposed a \$1 trillion program over 10 years to rebuild the nation's infrastructure, including airports, bridges, highways and ports. The federal budget includes a total of \$200 billion over 10 years to fund infrastructure initiatives, which the federal government would use to leverage an additional \$800 billion in spending from non-federal sources, such as the private sector. New York City could benefit from such an initiative, but details have not yet been made public.

VI. Citywide Savings Program

In November 2016, the Mayor announced a citywide savings program that was expected to generate \$2.1 billion during fiscal years 2017 through 2021. The January 2017 financial plan included actions that doubled the value of the program to nearly \$4.2 billion. At that time, the Mayor stated that additional actions would be included in the executive budget for FY 2018.

The April Plan includes actions that increase the cumulative value of the citywide savings program to \$6.1 billion during fiscal years 2017 through 2021. Nearly half (\$2.8 billion) of the program's value would be generated during fiscal years 2017 and 2018, with about \$1.1 billion generated annually thereafter (see Figure 10).

Reestimates are expected to generate nearly \$1.1 billion in FY 2017, but about half of that amount in subsequent years. In FY 2017, the City will benefit from the receipt of \$422 million in nonrecurring federal and State grants for social services and public transportation programs for prior years, and other nonrecurring savings.

Efficiencies are expected to generate \$159 million in FY 2017, although the savings are expected to grow to \$363 million by FY 2021 when the initiatives are fully implemented. Nonetheless, efficiencies make up less than one-quarter of the five-year value of the citywide savings program.

More than one-third of the savings from efficiencies are expected to come from shifting financial responsibility for certain programs from the City to the federal or State governments. The City also anticipates savings from a number of initiatives implemented across multiple agencies aimed at reducing procurement, leasing, equipment and overtime costs.

More than one-fifth of the savings in the citywide savings program (nearly \$1.3 billion) would come from lower debt service. Nearly one-third of the savings would come from the City not needing to borrow to meet its cash flow needs during the financial plan period, given its large cash reserves. Savings from variable-rate debt, excess State building aid and delays in capital commitments make up most of the balance.

The citywide savings program includes some initiatives that may fall short of target. In the event that this occurs, the State Comptroller recommends that the City be prepared with alternative initiatives. The Mayor has indicated that he is implementing a partial hiring freeze affecting managerial and administrative staff. Details on the freeze, including potential savings, are expected to be released following the adoption of the FY 2018 budget.

FIGURE 10
Citywide Savings Program
(in millions)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	Total
Agency Actions						
Reestimates	\$ 1,081	\$ 579	\$ 566	\$ 589	\$ 601	\$ 3,414
Efficiencies	159	264	310	341	363	1,438
Subtotal	1,240	843	875	931	964	4,853
Debt Service	295	421	232	207	125	1,280
Total	\$ 1,535	\$ 1,264	\$ 1,107	\$ 1,138	\$ 1,089	\$ 6,133

Note: Totals may not add due to rounding.
Sources: NYC Office of Management and Budget

VII. Revenue Trends

The April Plan assumes that revenues, including federal and State categorical aid, will total \$84.9 billion in FY 2018. Locally generated revenues (i.e., City funds) will account for 72 percent (\$61.1 billion) of this amount, with tax collections accounting for the largest share.

Total tax revenues grew at an average annual rate of 6.9 percent during fiscal years 2011 through 2015, but growth slowed to less than half that rate in FY 2016. While property tax collections increased by 7.8 percent, there was no growth in nonproperty tax collections that year (see Figure 11).

The April Plan assumes that the growth in tax collections will slow to 2.3 percent in FY 2017, as nonproperty taxes decline for the first time since FY 2010. The decline largely reflects the slowdown in job growth, a reduction in the number of real estate transactions, and changes in laws governing business taxation.

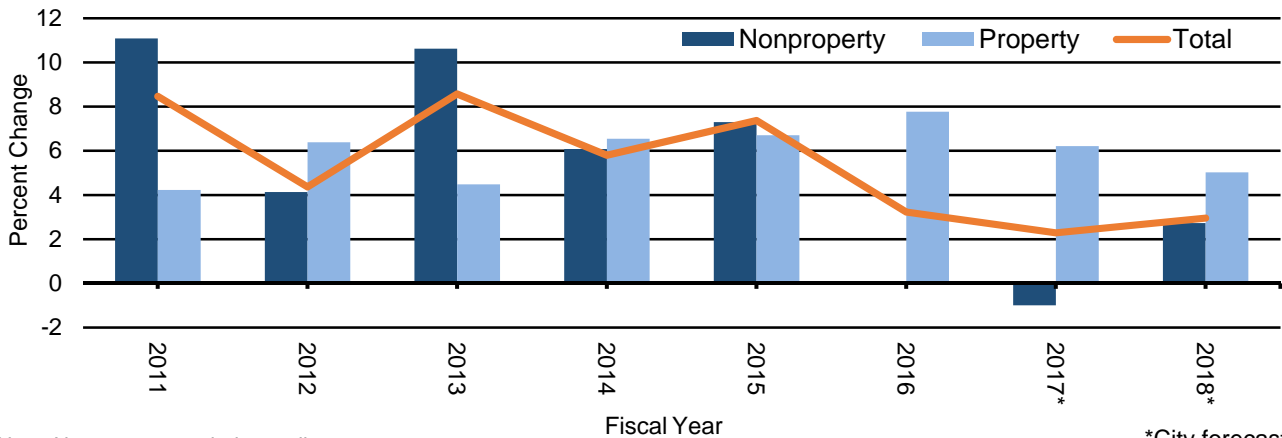
Growth in nonproperty taxes is projected to resume in FY 2018 (by 2.7 percent) as the local economy continues to expand, albeit slowly. Nonetheless, the increase in total tax revenue is expected to be modest (3 percent) and to remain well below the rate of growth earlier in the expansion.

Based on the most recent data for collections, OSC projects that tax collections could be lower than the City expects by \$150 million in FY 2017 and \$200 million in fiscal years 2018 through 2021. Business taxes account for much of this expected shortfall.

Other factors will also impact tax collections beginning in FY 2018. Sales tax collections will be lower under current State law (by \$50 million in FY 2018 and \$150 million in FY 2019) as the State recoups savings that accrued to the City from refinancing bonds of the Sales Tax Asset Receivable Corporation at lower interest rates.

The April Plan also anticipates \$731 million in revenue from the sale of taxi medallions during fiscal years 2019 through 2021, and \$100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. As discussed later in this section, the receipt of these proceeds is uncertain.

FIGURE 11
Annual Change in Taxes



Note: Nonproperty excludes audits.

Sources: NYC Office of Management and Budget; OSC analysis

*City forecast

FIGURE 12
City Fund Revenues
(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
General Property Tax	\$ 24,402	\$ 25,629	5.0%	\$ 27,292	\$ 28,618	\$ 29,929	5.3%
Personal Income Tax	11,291	11,655	3.2%	12,073	12,624	13,166	4.1%
Sales Tax	6,994	7,369	5.4%	7,881	8,245	8,592	5.3%
Business Taxes	5,820	6,027	3.6%	6,224	6,375	6,615	3.2%
Real Estate Transaction Taxes	2,419	2,298	-5.0%	2,359	2,462	2,510	3.0%
Other Taxes	2,669	2,640	-1.1%	2,700	2,747	2,802	2.0%
Tax Audits	1,251	850	-32.1%	721	721	721	-5.3%
Subtotal: Total Taxes	54,846	56,468	3.0%	59,250	61,792	64,335	4.4%
Miscellaneous Revenues	5,003	4,665	-6.8%	4,903	5,115	5,097	3.0%
Grant Disallowances	613	(15)	NA	(15)	(15)	(15)	0.0%
Total	60,462	61,118	1.1%	64,138	66,892	69,417	4.3%

Note: OSC has adjusted FY 2017 for changes in the School Tax Relief program to make it comparable to the City's financial plan forecasts.
Sources: NYC Office of Management and Budget; OSC analysis

The April Plan is based on the trends shown in Figure 12 and discussed below.

1. General Property Tax

Strong growth in property values has helped drive tax revenue growth throughout the current economic expansion. Between fiscal years 2010 and 2017, property values rose by 48 percent and collections increased by \$8 billion, or an average annual gain of 6 percent. Property tax collections are projected to total \$25.6 billion in FY 2018 (an increase of 5 percent), driven by continued growth in property values.

In FY 2018, property values are expected to grow by more than 7 percent to reach \$1.2 trillion. Growth will be the strongest (about 10 percent) for large residential properties. Values for one-, two- and three-family homes and commercial properties are expected to grow by more than 7 percent.

At the beginning of FY 2017, the City allocated \$1.8 billion for a reserve to cover delinquencies in collections, refund payments and tax abatements. Over the course of the year, it

reduced the reserve by \$400 million, freeing up the unneeded resources for other purposes. For FY 2018, the City raised the reserve to \$1.9 billion. If economic conditions permit, the City will draw down any unneeded reserves as the year progresses, realizing up to \$500 million in unanticipated revenues.

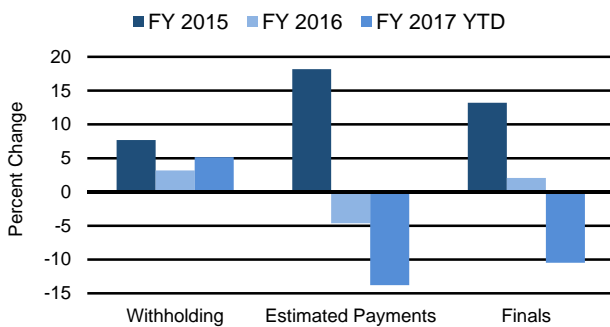
Property tax collections are forecast to grow by an average of 5.3 percent in fiscal years 2019 through 2021. Although property values are expected to grow at a slower rate during this period, revenue growth will be boosted by a pipeline of market value increases that are phased in from prior years.

2. Personal Income Tax

After increasing at an average annual rate of 8.3 percent during fiscal years 2010 through 2015, growth in personal income tax collections slowed to 1 percent in FY 2016 as job growth began to ease and as capital gains and securities industry bonuses declined.

Collections in FY 2017 are projected to be only slightly stronger (2.1 percent). While withholding collections from workers' paychecks increased by 5.2 percent during the first 10 months of the fiscal year, other components of the tax declined (see Figure 13).

FIGURE 13
Change in Major Components



Note: Withholding adjusted for change in School Tax Relief (STAR) program.
Sources: NYS Department of Taxation and Finance; OSC analysis

Year-to-date quarterly estimated payments (generated from capital gains and other nonwage income) declined by 13.8 percent. Given the weakness in nonwage income, the April 2017 final year-end payments declined by 11.3 percent compared to April 2016.

Although the City has reduced its expectations for estimated and final payments, OSC estimates that these collections are likely to fall \$75 million short of the City's revised target in FY 2017. However, the shortfall will likely be more than offset by higher payments from the State to correct for earlier distributional errors in collections.⁵ As of April 30, 2017, the City had received \$64 million more than assumed in the April Plan for the full year, and the amount is likely to increase further before the fiscal year ends.

⁵ The State collects the personal income tax for both the State and the City, and remits an estimate of the City's share each month. The State subsequently reviews the results and makes adjustments as necessary.

For FY 2018, the April Plan assumes that personal income tax collections will increase by 3.2 percent, with collections reaching \$11.7 billion.⁶ The increase is driven by withholding and estimated payments. Withholding is expected to grow by 5.4 percent as the tight labor market leads to stronger wage growth, offsetting the slowdown in job creation. Estimated payments are expected to rise for the first time in three years as the recent rally in the financial markets boosts capital gains.

OSC believes that the growth in withholding and estimated payments may be \$75 million less in FY 2018 than assumed in the April Plan. Once again, the shortfall would be more than offset by higher State payments for distributional errors. The April Plan assumes these payments will total \$559 million in FY 2018, \$161 million less than the average of the two prior years.

Potential changes in federal fiscal policies may impact economic activity and change taxpayer behavior in ways not yet reflected in the City's forecasts.

3. Sales Tax

The growth in sales tax collections has weakened in recent years, from an average of 5.7 percent in fiscal years 2013 and 2014 to 3.8 percent in FY 2015 and then 3.2 percent in FY 2016.⁷ Growth has remained subdued in FY 2017, reflecting slow job growth, lower spending by tourists and retail store closings.

The April Plan assumes that sales tax collections will increase by 4.5 percent in FY 2018 to reach \$7.5 billion. The City expects that stronger growth in wages will increase consumer spending. OSC is concerned that income growth may not be as strong as the City projects. In

⁶ Growth adjusted for a change in the State's School Tax Relief (STAR) program.

⁷ Adjusted for the impact of the sales tax intercept.

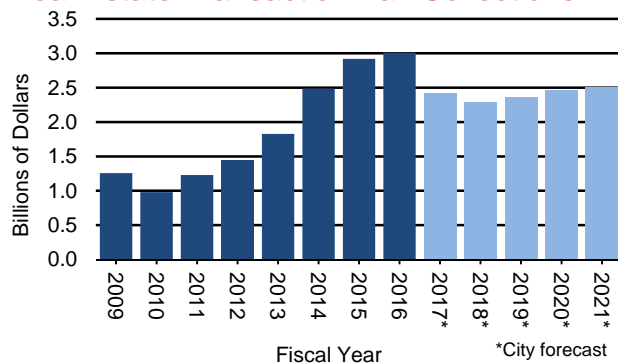
addition, NYC & Company forecasts a reduction in the number of international visitors to New York City in response to the President’s executive orders restricting travel from several largely Muslim nations. As a result, OSC projects that sales tax collections could be lower by \$50 million annually beginning in FY 2018.

4. Real Estate Transaction Taxes

After growing rapidly since the Great Recession, revenues from real estate transaction taxes (the real property transfer tax and the mortgage recording tax) declined sharply during the first three-quarters of FY 2017, driven by a 40 percent decline in the number of commercial transactions.

The April Plan assumes collections will decline by 19.6 percent in FY 2017 and by another 5 percent in FY 2018, falling to \$2.3 billion (see Figure 14). The April Plan assumes higher interest rates will result in a drop-off in commercial mortgage refinancing.

FIGURE 14
Real Estate Transaction Tax Collections



Sources: NYC Comptroller; NYC Office of Management and Budget

5. Business Taxes

Business tax collections have exhibited weakness since the State passed a corporate reform bill in April 2015 that combined the City’s banking and general corporate taxes. While this change was intended to be revenue-neutral, collections fell short of the City’s forecast by \$471 million in FY 2016.

A similar trend has developed in FY 2017. The City expects current-year collections to be \$374 million lower than projected at the beginning of the fiscal year. The City intends to offset half of the shortfall by drawing on \$185 million in business tax overpayments that were placed in reserve in FY 2015 when the tax law changes were first implemented.

However, collections were weaker than expected in April 2017. While the City is hopeful that collections will pick up during the remainder of the fiscal year, OSC is concerned that collections will remain weak, resulting in a shortfall of \$150 million in FY 2017.

The City expects that total business tax collections will increase by 3.6 percent to \$6 billion in FY 2018. Even if collections were to return to pre-reform levels in FY 2018, collections would still fall \$150 million short of the City’s forecast.

6. Audit Revenue

Each year, the Department of Finance conducts audits of individuals and businesses to ensure compliance with the tax code. Audit collections have averaged \$1.1 billion during fiscal years 2013 through 2016.

The City begins each fiscal year with a conservative forecast of collections, which it then increases as the year progresses. For FY 2017, the April Plan now projects that audit collections will reach \$1.3 billion, \$537 million more than was expected at the start of the year.

For FY 2018, the City is again beginning the year with a conservative forecast, expecting audit collections to fall to \$850 million. As in prior years, however, that amount is likely to increase as the year progresses.

Several factors could contribute to higher collections. The audit period now covers tax years 2011 and later, which were years of stronger economic growth as the recovery from the Great Recession progressed. In addition, the City is increasing the level of resources devoted to business tax audits in the wake of the recent tax law changes.

7. Miscellaneous Revenues

Miscellaneous revenues include recurring resources (such as licenses, fines and fees) and nonrecurring resources (such as proceeds from the sale of taxi medallions or City property). Recurring resources have grown steadily, increasing at an average annual rate of 5.9 percent during the past three years. The April Plan assumes these revenues will decrease by 3.2 percent in each of fiscal years 2017 and 2018. Based on collection trends, OSC estimates that recurring revenues could be higher by \$75 million annually beginning in FY 2017.

The State authorized the sale of 2,000 additional taxi medallions in 2012. After the sale of 350 medallions in FY 2014, the City has repeatedly postponed the sale of the remaining 1,650 medallions because the growing presence of alternatives to taxis, such as Uber and Lyft, has significantly impacted the market. The average sale price for a taxi medallion peaked at \$1 million in calendar year 2014, but by 2016 the average sale price was nearly cut in half

(\$594,700). Weakness in market conditions have continued in the first quarter of 2017, and the average sale price fell even further (\$404,000).

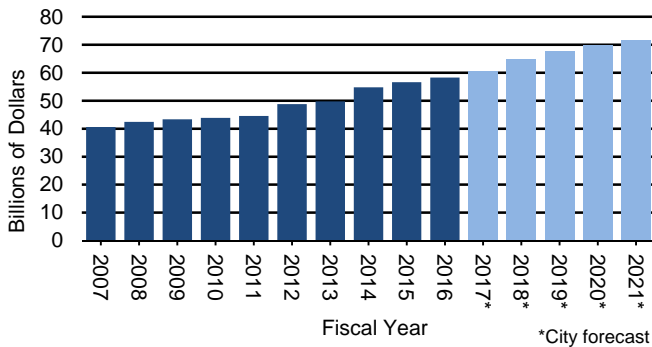
The April Plan still anticipates selling the remaining medallions over five years, and the City expects to receive \$731 million in proceeds from sales during the financial plan period (\$107 million in FY 2019, \$257 million in FY 2020 and \$367 million in FY 2021). Until the City tests the market, there is a risk that the expected amount may not be realized.

The City expects to receive \$100 million in FY 2020 from development opportunities at properties leased to the Health and Hospitals Corporation. The City intends to transfer the proceeds to the Corporation to help balance its budget. If these development opportunities do not materialize as expected, the City may be called upon to make up the difference, or the Corporation may be required to implement deeper cuts than already planned.

VIII. Expenditure Trends

The Mayor’s executive budget for FY 2018 totals \$84.9 billion, including programs funded with federal and State categorical grants. The portion funded with locally generated revenue (i.e., City funds) totals \$61.1 billion. After adjusting for surplus transfers, which can mask expenditure trends, City-funded spending (including reserves) would reach nearly \$64.8 billion (see Figure 15).

FIGURE 15
City-Funded Expenditures



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

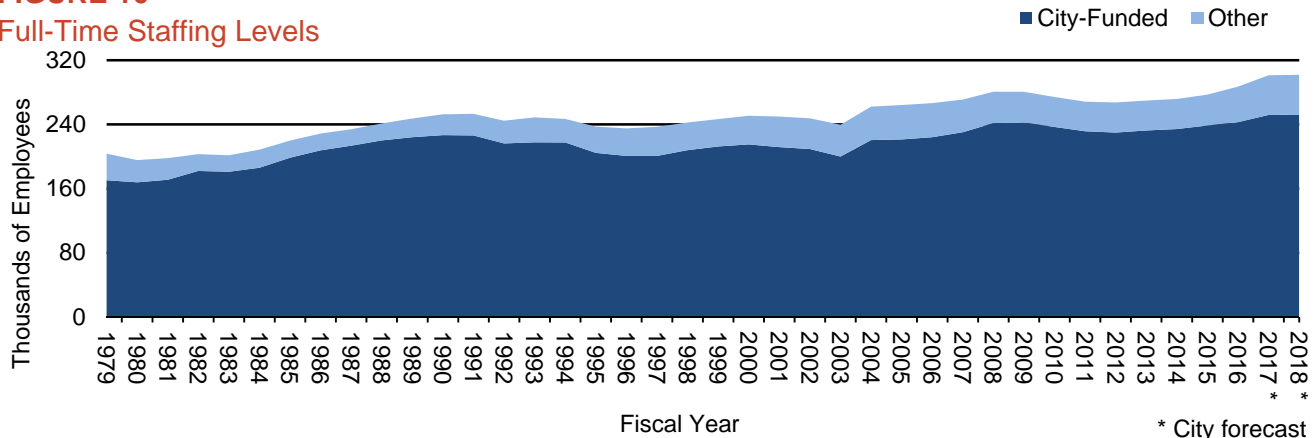
City-funded spending is projected to grow by 6.7 percent in FY 2018 (4.5 percent excluding reserves), slightly faster than in FY 2017. Spending is growing faster than inflation, driven by the cost of labor agreements, higher costs for employee fringe benefits and debt service.

The full-time work force (including jobs funded by federal and State categorical grants) declined during fiscal years 2010 through 2012 as the City addressed the aftereffects of the Great Recession. Staffing increased slowly during FY 2013, but accelerated beginning in FY 2014 (see Figure 16).

Staffing increased by 17,228 employees between fiscal years 2013 and 2016. In FY 2016, the City added 9,829 employees, the largest one-year increase since FY 2004. (Teachers, police officers and correction officers accounted for nearly two-thirds of the new hires.) These additions increased the work force to the highest level since the fiscal crisis (287,002 full-time employees, of which 242,878 were City-funded).

The April Plan assumes the addition of 14,291 employees during FY 2017, with hiring concentrated in the health and welfare agencies and the Department of Education. While the City added 6,294 employees during the first nine months of FY 2017, this was 7,836 fewer employees than planned. The April Plan assumes a small increase (450) in the City-funded work force during FY 2018, mostly in the Department of Education.

FIGURE 16
Full-Time Staffing Levels



Note: Staffing levels are as of June 30 of each fiscal year.

Sources: NYC Office of Management and Budget; OSC analysis

FIGURE 17
Trends in City-Funded Spending Categories
(in millions)

	FY 2017	FY 2018	Annual Growth	FY 2019	FY 2020	FY 2021	Average Three-Year Growth Rate
Salaries and Wages	\$ 17,221	\$ 18,878	9.6%	\$ 20,107	\$ 20,820	\$ 21,289	4.1%
Pension Contributions	9,251	9,427	1.9%	9,722	9,792	9,857	1.5%
Medicaid	5,813	5,813	0.0%	5,813	5,813	5,813	0.0%
Debt Service	6,064	6,264	3.3%	6,967	7,657	8,152	9.2%
Health Insurance	4,531	4,956	9.4%	5,385	5,910	6,527	9.6%
Other Fringe Benefits	2,729	2,790	2.2%	2,975	3,280	3,447	7.3%
Energy	720	760	5.6%	780	811	849	3.8%
Judgments and Claims	576	552	-4.2%	567	585	600	2.8%
Public Assistance	630	708	12.4%	713	719	719	0.5%
Other	13,338	13,447	0.8%	13,449	13,238	13,234	-0.5%
Subtotal	60,873	63,595	4.5%	66,478	68,625	70,487	3.5%
General Reserve	300	1,000	NA	1,000	1,000	1,000	NA
Prior Years' Expenses	(400)	---	NA	---	---	---	NA
Capital Stabilization Reserve	---	250	NA	250	250	250	NA
Total	\$ 60,773	\$ 64,845	6.7%	\$ 67,728	\$ 69,875	\$ 71,737	3.4%

Note: Debt service has been adjusted for surplus transfers.
Sources: NYC Office of Management and Budget; OSC analysis

The April Plan is based on the trends shown in Figure 17 and discussed below.

1. Collective Bargaining

As of May 2017, the City had negotiated new labor agreements through FY 2018 with all of the major unions that represent nearly all of the City's work force. The agreements call for wage increases of 10 percent over seven years for civilian employees and 11 percent over seven years for uniformed employees. The City expects the remaining unions with expired contracts to reach conforming agreements.

The agreements also compensate members of the United Federation of Teachers (UFT) and other employees for two annual wage increases of 4 percent that were provided to most other municipal unions in 2009 and 2010 but not to these employees.

In November 2015, a three-member arbitration panel awarded police officers two annual wage

increases of 1 percent for fiscal years 2011 and 2012, which was consistent with the City's financial plan.

In January 2017, the City and the Patrolmen's Benevolent Association (PBA) reached agreement on a contract that calls for wage increases of 9 percent over a five-year period, which conforms to the wage pattern for other uniformed employees. The contract was ratified by the PBA's members in February 2017.

The PBA contract calls for officers to receive a salary differential (2.25 percent of base salary) for patrol duties associated with the Mayor's neighborhood policing initiative. The cost of the differential will be offset by a reduction in the salary schedule for newly hired police officers.

These labor agreements are expected to cost a total of \$13.8 billion during fiscal years 2014 through 2018 (the end of the contract period). The cost will be partially offset by resources that had been set aside by the City in its labor

reserve prior to reaching new wage agreements (\$3.5 billion), and from health insurance savings (\$4.4 billion) from a separate agreement between the City and its unions. The net budgetary impact will total \$5.9 billion.

The net budgetary impact will be greatest during fiscal years 2018 through 2021, and will peak at \$4 billion in FY 2021. Beginning in FY 2018, the cost will continue to rise after the expiration of the contracts because of lump-sum payments to compensate members of the UFT and other employees for the time they went without wage increases, as well as the full impact of wage increases granted in prior years.

The April Plan includes resources to fund annual wage increases of 1 percent after the expiration of the current round of collective bargaining, which will begin during FY 2018 for most employees. The actual cost of the next round of collective bargaining will be determined through negotiation or arbitration, and could be higher than assumed in the April Plan. Wage increases at the projected inflation rate, for example, would increase costs by \$147 million in FY 2018, \$390 million in FY 2019, \$923 million in FY 2020 and nearly \$1.6 billion in FY 2021.

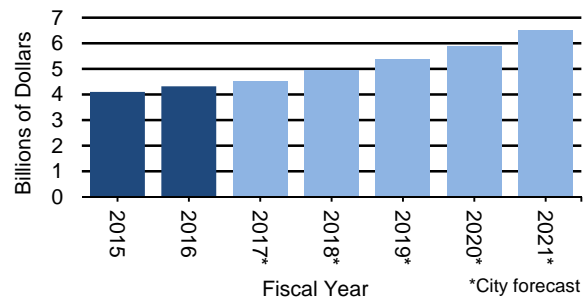
The State recently approved legislation, jointly supported by the City and the PBA, which increases the disability pension benefits of police officers hired after June 30, 2009.⁸ Under the legislation, police officers who elect to receive the improved benefit will contribute an additional 1 percent of their salaries toward the cost of the benefit. The legislation was consistent with legislation enacted in 2016 to improve the disability benefits of firefighters.

⁸ Police officers hired after June 2009 are eligible for disability payments equal to 50 percent of their highest five-year average salary, offset by 50 percent of their Social Security Disability

2. Health Insurance

In May 2014, the City and the Municipal Labor Committee agreed to identify cumulative health insurance savings of \$3.4 billion during fiscal years 2015 through 2018 to help fund wage increases for municipal employees. Despite these savings, the City-funded cost of health insurance will reach \$6.5 billion by FY 2021 (see Figure 18), \$2.2 billion (52 percent) more than in FY 2014 before the agreement took effect.

FIGURE 18
Health Insurance Costs
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

The agreement calls for savings of \$400 million in FY 2015, \$700 million in FY 2016, \$1 billion in FY 2017 and \$1.3 billion in FY 2018, with recurring savings of \$1.3 billion in subsequent years. The agreement includes provisions that provide incentives to both the City and the unions to exceed these targets.

While the City is on track to meet and perhaps exceed the target for FY 2018, more than three-quarters of the \$3.4 billion in cumulative savings has come from lower-than-planned increases in health insurance premiums and other administrative actions. Cost-containment initiatives are expected to save \$593 million (mostly from higher co-payments), or 17 percent of the total.

Insurance benefit. Officers hired before that date receive 75 percent of their highest salary with no Social Security offset.

3. Pension Contributions

After rising rapidly between fiscal years 2003 and 2012, the growth in City-funded pension contributions slowed during the following three years. The slower rate of growth reflected the impact of changes in assumptions and methodologies used to calculate City pension contributions, better-than-expected investment earnings, and savings from lower-cost pension plans for employees hired after March 31, 2012.

Pension contributions resumed growing in FY 2015, and are projected to rise from \$8.1 billion in FY 2014 to \$9.7 billion by FY 2019 before leveling off (see Figure 19). This trend reflects revised mortality tables to account for longer life expectancies and lower-than-expected investment earnings during fiscal years 2015 and 2016. Pension contributions will average 15 percent of City fund revenues during the financial plan period.

The unfunded net liability of the City’s five pension systems has also grown, rising by \$11.7 billion to \$64.8 billion in FY 2016. In the aggregate, the pension systems had sufficient assets to fund (on a market-value basis) 65.6 percent of their accrued pension liabilities at

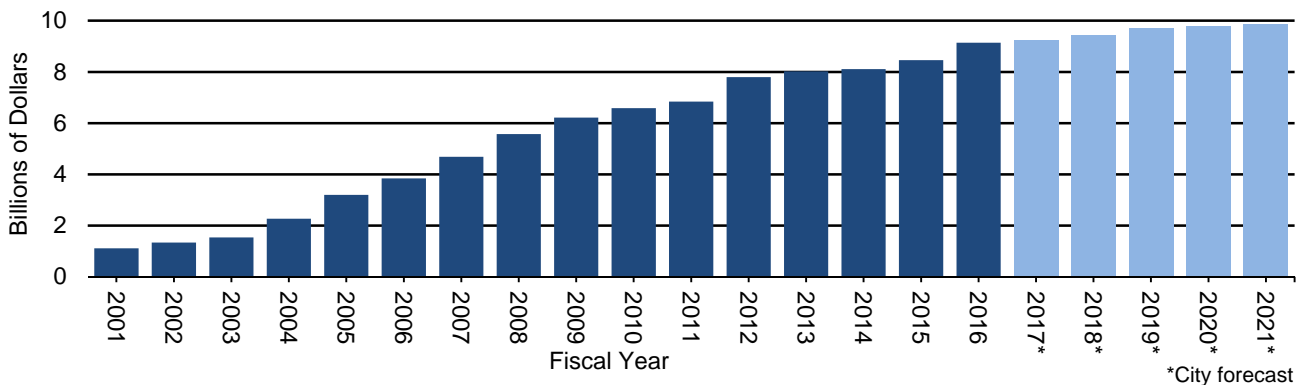
the end of FY 2016, which was 4.5 percentage points less than in the prior year.

As of April 30, 2017, the pension funds had earned about 10.7 percent on their investments, compared with an expected return of 7 percent for the full fiscal year. If this gain is maintained through the end of the fiscal year, the City could realize savings of \$65 million in FY 2019, \$130 million in FY 2020 and \$195 million in FY 2021.

The City has engaged the services of an independent actuarial consultant, as required under the City Charter, to conduct a biennial audit of the pension system. The April Plan assumes that the assumptions and methodologies used to calculate pension contributions will remain unchanged.

The prior consultant recommended that the pension systems revise their overtime assumptions to reflect the increased use of overtime, which would have raised contributions by about \$250 million annually, but this recommendation was not implemented. The consultant may affirm the recommendations of the previous consultant, or make other recommendations, which could increase (or decrease) planned contributions.

FIGURE 19
Pension Contributions
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

4. Debt Service

City-funded debt service grew slowly between fiscal years 2011 and 2016, but growth will accelerate during the financial plan period (see Figure 20) as the City expands the capital program. Debt service increased at an annual average rate of 3.4 percent between fiscal years 2011 and 2016, but will grow by 7.6 percent annually over the next five years to reach \$8.2 billion by FY 2021. In total, debt service would increase by \$2.5 billion (45 percent).

Borrowing is expected to more than double from \$3.7 billion in FY 2016 to more than \$9 billion annually from FY 2019 through FY 2021. By FY 2021, debt outstanding would reach \$91.7 billion, \$22 billion more than in FY 2016.

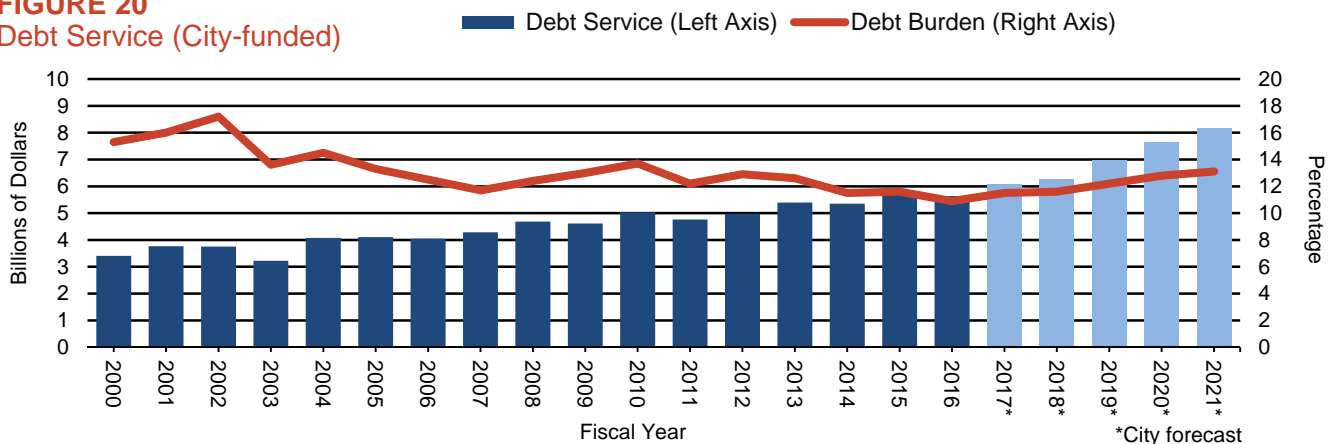
Figure 20 also shows that debt service as a share of tax revenue (i.e., the debt burden) would rise from 10.9 percent in FY 2016 to 13.1 percent in FY 2021. Although debt service would account for a larger share of tax revenue, the share would remain below 15 percent, a level that is considered high. To prevent debt service from rising too quickly as a share of tax revenues, the City has created a capital stabilization reserve (\$250 million annually beginning in FY 2018).

The City's debt service projections are based on a number of assumptions, which may increase or decrease the debt burden. For example, the debt service forecasts assume that the City will meet its annual capital commitment target, but the City has a long history of falling short of this target. The April Plan assumes City-funded capital commitments will total \$16.1 billion during FY 2018, compared with \$6.2 billion, on average, during fiscal years 2011 through 2016.

Debt service is also dependent on interest rates. In recent years, interest rates have been at historic lows and the City has realized significant savings from refinancing outstanding debt and from variable-rate debt. Since the beginning of the current fiscal year, for example, the City has realized nearly \$1.3 billion in debt service savings during the financial plan period.

The Federal Reserve has begun to raise short-term interest rates, which could reduce the opportunities for debt service savings in future years. In the near term, the City may continue to realize debt service savings given its conservative interest-rate assumptions. For FY 2018, OSC estimates that the City could realize savings of \$125 million from lower-than-expected variable interest rates.

FIGURE 20
Debt Service (City-funded)



Note: Debt service amounts are adjusted for prepayments and defeasances.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

Changes in federal tax policy could also affect the City's borrowing costs. Congress and the President support revising the federal tax code, including a reduction in personal income taxes. A reduction in the top tax rate could reduce the appeal of tax-exempt bonds. In the past, Congress has also considered capping or eliminating the federal tax exemption for municipal bonds. If that were to occur, New York City might have to increase the interest rate on its bonds to attract investors, which would increase borrowing costs.

5. Medicaid

Medicaid provides health insurance to low-income children and adults, and is the largest payer of long-term care. It also provides subsidies to health care providers, such as the Health and Hospitals Corporation, which serve large numbers of low-income patients and uninsured patients.

Medicaid enrollment grew slowly in the years following the recession, but accelerated with the implementation of the federal Affordable Care Act (ACA) in January 2014. Currently, 40 percent of the City's population is enrolled in Medicaid.

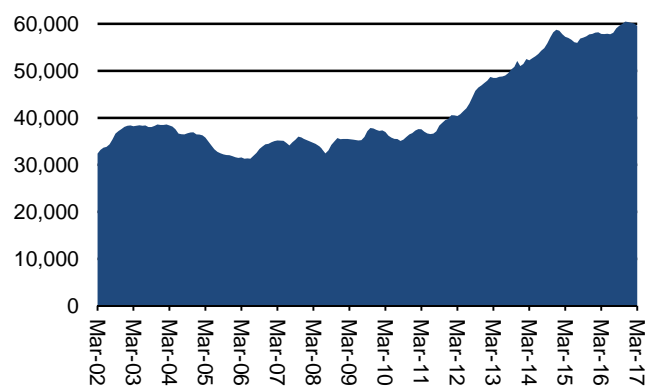
The April Plan assumes that the City-funded share of Medicaid will total \$5.8 billion in FY 2017 (10 percent of City-funded revenue) and will remain at that level because the State assumed financial responsibility for the growth in the local share. These estimates assume no change in federal Medicaid policies.

The American Health Care Act of 2017, if enacted into law, could result in 1.1 million City residents losing Medicaid coverage, and another 460,000 losing insurance through plans offered through the health insurance exchange. Congress is also considering legislation that would place a cap on Medicaid funding to the states. Currently, funding rises or falls based on the number of enrollees and the amount of services rendered.

6. Homeless Services

The number of homeless people residing in shelters operated by the Department of Homeless Services (DHS) increased rapidly beginning in 2011, reaching a record of nearly 60,500 in November 2016 (see Figure 21). Despite a significant increase in homeless prevention initiatives and subsidized housing, the caseload remains elevated, declining only slightly to 59,500 in March 2017.

FIGURE 21
People in Homeless Shelters



Source: NYC Department of Homeless Services

The cost of homeless services has also increased rapidly in recent years, growing from \$1 billion in FY 2013 to a record \$1.8 billion in FY 2017 (\$1 billion in City funds). The trend reflects the growth in the shelter population and the City's greater reliance on more costly short-term housing (e.g., commercial hotels).

In February 2017, the Mayor released a comprehensive plan to address homelessness. The plan calls for building 90 new shelters across the City over the next five years to reduce the City's reliance on costly commercial hotels. It also calls for expanding homeless prevention initiatives and housing programs.

To address homelessness statewide, the State approved a \$2.5 billion plan to create and preserve affordable and supportive housing. The plan includes \$100 million dedicated to the City

for this purpose. In addition, the plan includes statewide funding for supportive (\$950 million), affordable (nearly \$500 million) and senior housing (\$125 million), among other initiatives. These funds will be distributed on a competitive basis, and the City will benefit from the creation of new State-funded housing for the homeless.

The April Plan assumes that the cost of homeless services will decline by \$143 million in FY 2018, driven by a reduction in the single-adult shelter population. Although the portion of the shelter population that consists of families with children appears to have stabilized, the single-adult population continues to rise, reaching a record level of 13,900 individuals in March 2017. Until the caseload begins to decline, the City-funded cost of sheltering the homeless could be higher by \$112 million annually beginning in FY 2018.

7. Uniformed Agencies

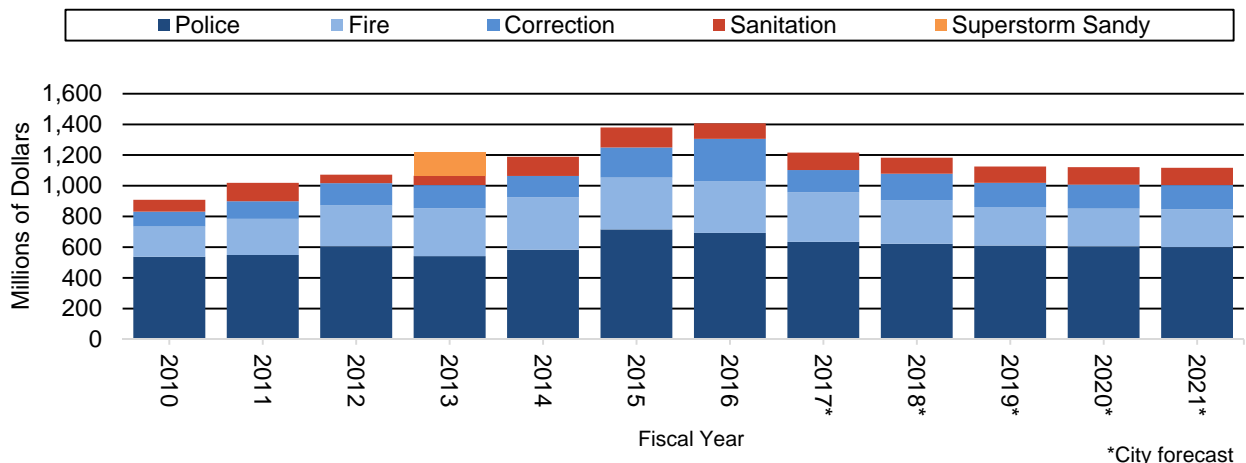
Overtime costs (both for uniformed and civilian employees) in the four uniformed agencies increased by 55 percent between fiscal years 2010 and 2016, reaching a record \$1.4 billion (see Figure 22). The increase has been concentrated in the Police Department and the Department of Correction.

Overtime costs at the Police Department were \$693 million in FY 2016, half of the total for all four uniformed agencies. The City assumes that police overtime will decline to \$635 million in FY 2017, but that seems unlikely since overtime totaled \$576 million through April and is on pace to exceed \$700 million for the full year.

Overtime costs at the Department of Correction doubled between fiscal years 2014 and 2016, reaching \$275 million. The growth was largely driven by a high attrition rate (which led to understaffing) and new federal mandates. In an effort to reduce overtime, the Department of Correction added 1,047 correction officers during the first nine months of FY 2017 and plans to add another 457 officers by the end of FY 2018. The April Plan assumes that uniformed staffing will reach 10,420 by the end of FY 2018, the highest since FY 2002.

The Mayor recently announced his conditional support for calls to close the nine inmate facilities located on Rikers Island, where the City houses about 7,000 inmates. The Independent Commission on New York City Criminal Justice and Incarceration Reform has recommended that the City replace these facilities with modern correctional facilities in each of the City's boroughs at a cost of \$10.6 billion.

FIGURE 22
Uniformed Agency Overtime



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

*City forecast

The April Plan assumes that overtime costs in the uniformed agencies will total \$1.2 billion in FY 2017, \$191 million less than last year. Although overtime is on track to exceed the City's forecast by \$200 million, savings in other personal services costs and the receipt of federal funding, such as reimbursement for protecting the President and his family, could offset the unfunded overtime liability in FY 2017. However, OSC estimates that overtime costs could exceed the City's forecast by \$125 million annually beginning in FY 2018.

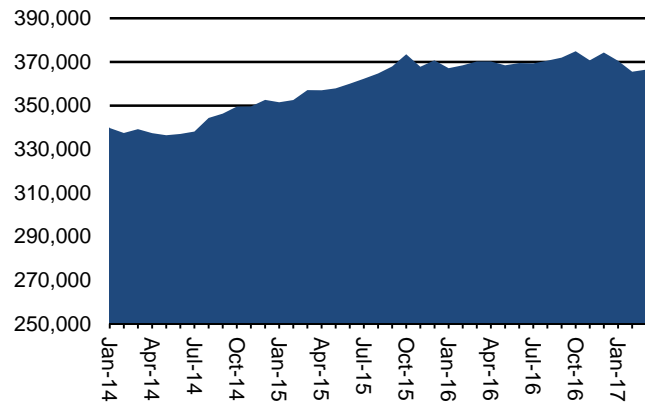
8. Public Assistance

The largest public assistance programs in New York State are the Family Assistance (FA) and Safety Net Assistance (SNA) programs. The FA program, which is fully federally funded, provides five years of lifetime benefits to low-income families with children. The SNA program provides benefits to families that have exhausted their federal benefits and to low-income individuals who are ineligible for federal benefits.

The FA caseload fell sharply in response to reforms enacted in the 1990s, including the introduction of time limits and work requirements. After five years, there was a sharp increase in SNA enrollment as families exceeded their lifetime FA benefits and transferred to the State program.

The City's public assistance caseload has remained relatively stable since 2008, though in recent years it has increased. The caseload rose by 11 percent between May 2014 and October 2015 to reach 373,500 (see Figure 23). Most of the increase occurred in the SNA program, which is funded by the State and City.

FIGURE 23
Public Assistance Caseload



Source: NYC Human Resources Administration

The City attributes most of the increase to changes in policies rather than economic conditions. For example, the City and State have granted public assistance recipients greater flexibility in scheduling appointments, which has reduced the number of people who lose their benefits for missing appointments.

The City also increased the amount of hours of education and training that can be applied to a recipient's work requirements, which has allowed more low-income students to receive benefits. As part of a strategy to address homelessness, the City has provided more emergency rental assistance to families at risk of eviction.

In March 2017, the public assistance caseload totaled 366,400, slightly lower than the caseload at the beginning of the fiscal year. The April Plan assumes that the caseload will reach 371,000 during FY 2018 and then remain at this level through FY 2021. The City-funded cost of public assistance is expected to total \$708 million in FY 2018. (In FY 2018, the federal and State governments are expected to fund \$887 million of public assistance costs.)

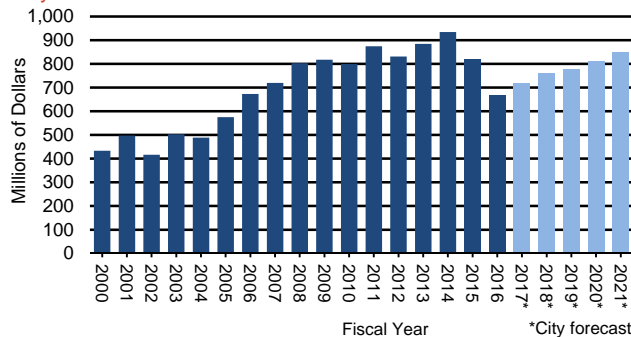
9. Energy

Energy costs (i.e., electricity, fuel and heat) reached a record high of \$935 million in FY 2014 (see Figure 24). In FY 2015, as prices for electricity, fuel and heat fell sharply, City energy costs declined by 12 percent, and then fell by another 18 percent to \$669 million during FY 2016, when the winter was relatively mild.

The April Plan assumes that energy costs will increase 8 percent to reach \$720 million in FY 2017 and then continue to increase, reaching \$849 million by FY 2021. Although energy costs are expected to rise, the forecast for FY 2021 is lower than the level of energy costs incurred in FY 2013.

The Governor has announced an agreement to close the Indian Point nuclear power plant by 2021. The agreement will not affect New York City or the Metropolitan Transportation Authority because these entities have long-term agreements with the New York Power Authority, which has not purchased electricity from Indian Point since 2013.

Figure 24
Energy Costs
City-Funded



Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

IX. Semi-Autonomous Entities

1. Health and Hospitals Corporation

The Health and Hospitals Corporation (the largest municipal hospital system in the country) continues to face serious financial challenges. Factors contributing to the crisis include large numbers of uninsured patients, increased competition for Medicaid patients and high overhead costs.

The Corporation has increasingly relied on the City to meet its financial obligations. In FY 2018, the City will provide \$1.8 billion in financial support, representing nearly one-third of the Corporation's total revenues. Despite this assistance and its own efforts, the Corporation projects a \$1.9 billion budget deficit by FY 2021.

About half of the Corporation's budget would be funded by the federal government (about \$3.3 billion annually). However, some of these resources may be at risk given that the federal government is contemplating changes in Medicaid and health care.

The House of Representatives recently approved the American Health Care Act (AHCA). Beginning in 2020, the AHCA would eliminate the enhanced Medicaid reimbursement rate for certain new enrollees, reduce health insurance subsidies and would cap federal Medicaid funding to the states.

If enacted into law, the AHCA would adversely affect the Corporation's budget. The Corporation estimates that 200,000 of its patients could lose insurance coverage, resulting in the loss of \$500 million annually in patient revenue.

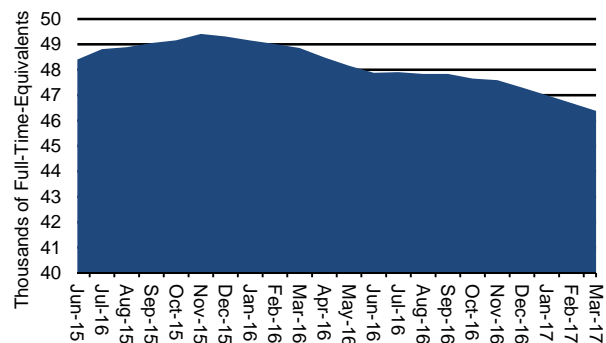
Last year, the Corporation's financial situation was worse than originally projected. As a result, the City relieved the Corporation of \$337 million in financial obligations, including debt service on bonds issued by the City on the Corporation's behalf. The City still expects to receive reimbursement for the cost of medical malpractice claims (\$140 million) and employee fringe benefits (\$24 million) during the financial

plan period, but these resources could be at risk given the Corporation's ambitious transformation plan and potential reductions in federal aid.

The Corporation is taking action to improve its financial situation, with the expectation of generating cumulative resources of \$3.6 billion over the next four years. These actions include restructuring health care services (\$1.4 billion), improving revenue collections (\$632 million), creating procurement efficiencies (\$582 million), reducing staffing (\$400 million) and increasing MetroPlus enrollment (\$284 million).

While the Corporation has not yet announced the details of its restructuring program, it has made progress in reducing staffing after some initial difficulties. Staffing has declined by more than 3,000 FTEs between November 2015 and March 2017 (see Figure 25), a reduction of 6 percent.

FIGURE 25
Health and Hospitals Corporation Staffing



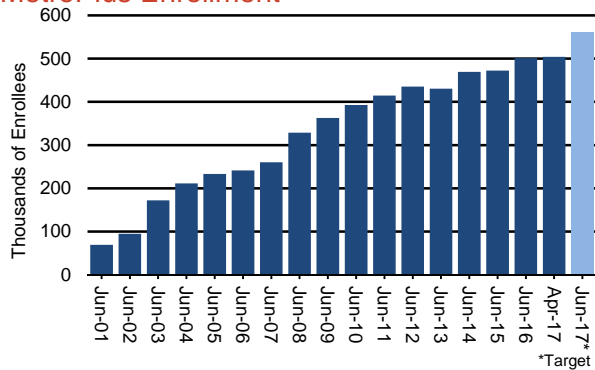
Sources: Health and Hospitals Corporation; OSC analysis

The Corporation has also made progress improving revenue collections and reducing procurement costs. However, it remains to be seen whether the Corporation can meet its ambitious targets during the financial plan period.

Enrollment in MetroPlus is rising, but not as fast as the Corporation had hoped. In April 2015, the Corporation announced a MetroPlus enrollment target of 1 million members by the end of calendar year 2020, but one year later the target was reduced by one-third to 675,000 members.

The Corporation had expected MetroPlus enrollment to increase by almost 60,000 members during FY 2017, but as of April 1, 2017 it had increased by only 2,877 members (see Figure 26). In response, the Corporation is likely to again revise its enrollment target downward.

FIGURE 26
MetroPlus Enrollment



Sources: Health and Hospitals Corporation; OSC analysis

The Corporation is assuming that the federal government will extend Medicaid coverage to undocumented immigrants for nonemergency services. However, this assumption seems inconsistent with the policy positions taken by the President regarding undocumented immigrants.

Although the Corporation has postponed this initiative until FY 2019, it appears unlikely that it will receive the \$96 million annually it expects from extending Medicaid coverage for undocumented immigrants. It is more likely that existing revenue streams could be put at risk.

In May 2017, the Corporation indicated that it would end the fiscal year with a cash balance of \$186 million, enough to pay its bills for 12 days. However, the number of patients receiving services at the Corporation’s facilities continues to decline, which has caused the Corporation to reduce its projections for patient revenues.

2. New York City Housing Authority

The New York City Housing Authority (NYCHA) is an important component of the City’s supply of affordable housing. NYCHA manages approximately 176,000 apartments that house nearly 400,000 residents, which amounts to 8 percent of the City’s rental apartments. As of February 2017, nearly 257,500 families were waiting for an apartment to become available.

Federal funds make up 59 percent (\$1.9 billion) of NYCHA’s operating budget and 90 percent of the portion not funded with rent proceeds. The capital budget also relies heavily on federal funding. However, as a result of shortfalls in federal funding, coupled with other fiscal and management challenges, the City’s public housing properties have fallen into disrepair.

In response, NYCHA has developed a 10-year plan to close projected budget gaps and to improve the condition of its facilities. As part of the plan, the City has increased its financial support.

Although NYCHA’s financial plan projects a surplus of \$21 million in 2017 and \$61 million in 2018, these estimates assume the receipt of \$140 million in 2017 and \$133 million in 2018 from the sale of development rights. While NYCHA continues to have discussions about such opportunities, it has not yet reached agreements to realize the anticipated amounts. In addition, NYCHA is concerned that the President’s budget would reduce federal funding in 2018 (by up to \$130 million to its operating budget and by \$210 million to its capital budget).

NYCHA’s five-year capital program is also greatly underfunded. The City has agreed to increase its contribution by \$413 million to nearly \$1 billion, and the recently enacted State budget allocates \$200 million for capital projects. Even with these additional resources, the capital program would fall \$11.5 billion short of NYCHA’s stated capital needs. NYCHA is

working on a revised capital needs assessment, which is likely to show a much larger unfunded capital need.

To narrow the gap in its capital program, NYCHA is counting on \$3 billion in public and private financing by enrolling 15,000 units over 10 years in the federal Rental Assistance Demonstration (RAD) program. NYCHA closed its first RAD transaction in December 2016, securing \$325 million for capital improvements to 1,400 units in Far Rockaway, Queens. It also received federal approval to seek financing for an additional 1,700 units (\$300 million). Nevertheless, there is no assurance that the remaining units will be approved or that the full \$3 billion in financing will be realized.

3. Metropolitan Transportation Authority

In September 2016, OSC issued a report that concluded that the Metropolitan Transportation Authority (MTA) had recovered from the recession but that it still faced challenges. Labor agreements were set to expire beginning in December 2016, and the State and City had not identified the sources of their \$9.2 billion contributions to the MTA's capital program.

On January 15, 2017, the MTA reached a labor agreement with the Transport Workers Union (TWU), its largest union. The agreement covers the period from January 2017 to May 2019, and calls for a total wage increase of 5 percent and enhanced dental benefits.

Although the cost of the TWU agreement was greater than the MTA had budgeted, the MTA was able to accommodate the cost within its financial plan. The agreement permits the TWU to reopen negotiations if the Long Island Rail Road's unions receive larger wage increases than those provided to the TWU. The MTA has yet to reach agreement with the unions representing the commuter railroads.

The enacted State budget for SFY 2017-2018 appropriates \$4.5 billion in tax revenues and State subsidies to the MTA, \$125 million less than was anticipated by the MTA in November 2016. Metropolitan Mass Transportation Operating Assistance was \$75 million less than expected, and the State reduced by \$65 million the amount of funding appropriated to the MTA to offset the impact of exempting schools and small businesses from the metropolitan commuter transportation mobility tax.

The MTA's current financial plan reflects the impact of the enacted State budget and the TWU labor agreement. While it projects positive year-end cash balances through calendar year 2019 on the assumption that fares and tolls will increase by 4 percent biennially, it projects a budget gap of \$372 million in 2020 (\$53 million larger than projected in November 2016).

The State has agreed to contribute \$8.3 billion toward the MTA's \$29.6 billion capital program for 2015-2019. While the State has identified the sources of the first \$1 billion (\$750 million in bond proceeds and another \$250 million in financial settlement funds), it has yet to identify the sources of the remaining \$7.3 billion. The State intends to provide the MTA with these resources after the MTA has effectively exhausted all other sources of capital funding, but no later than SFY 2025-26 or the completion of the capital program.

On May 24, 2017, the MTA board approved a proposed amendment to the current five-year capital program. The amendment would increase the size of the capital program by nearly \$2.9 billion. Of this amount, \$2 billion would be devoted to a new Long Island Rail Road expansion project and \$700 million to the second phase of the Second Avenue Subway (raising the total for this project to \$1.7 billion). The proposed amendment is subject to approval by the State Capital Program Review Board.

The increased cost of the 2015-2019 capital program would be funded mostly through additional borrowing (\$1.6 billion), federal funds allocated by the State (\$450 million) and pay-as-you-go financing (\$345 million). The MTA is scheduled to release a revised financial plan in July 2017, which will show the impact of the capital program amendment on the operating budget, and on future fare and toll increases.

The enacted State budget includes \$1.5 billion in new appropriations, in addition to \$2.9 billion appropriated in SFY 2016-17, which could be used for capital grants if the State elects to provide direct financial support. In addition to capital grants, the State's fulfillment of its capital commitment could include authorizing the MTA to issue its own bonds backed by an existing or new State revenue source.

The enacted budget appropriated an additional \$65 million for the MTA's 2015-2019 capital program and another \$65 million for Long Island Rail Road station projects, which have been included in the proposed amendment to the capital program.

The MTA is dependent, in part, on the federal government to help fund capital improvements. Although it receives no operating budget subsidies, nearly one-quarter (\$6.9 billion) of the MTA's 2015-2019 capital program is expected to be funded by the federal government.

The President has proposed eliminating the New Starts program, which the MTA has used to fund some of its expansion projects. The MTA expects to request that the federal government fund approximately \$2 billion of the \$5 billion estimated cost of the next phase of the Second Avenue Subway, but this funding may now be at risk.

4. Department of Education

New York City has the largest public school system in the nation, operating more than 1,800 schools and serving more than 1.1 million students. The April Plan allocates \$30.8 billion to the Department of Education in FY 2018 to cover the cost of educating students in the City's public schools. Of this amount, \$17.4 billion (57 percent) would come from the City and \$11.4 billion (37 percent) would come from the State, with \$1.8 billion from the federal government (6 percent).

The recently enacted State budget increases general support for the City's public schools by \$387 million in FY 2018. The State has also increased funding for charter schools for the upcoming school year, but the State budget requires future increases to be paid by the City. Although mayoral control of New York City schools has not been extended, the State legislative session continues until June 2017, when mayoral control is set to expire.

The Mayor's executive budget proposes to offer free full-day prekindergarten to all three-year-olds. Initially, the City will allocate \$36 million in FY 2018 to provide services in two school districts. This amount will rise to \$177 million annually by FY 2021, when the program will cover eight districts. To serve all three-year-olds in every school district will require an additional \$700 million annually, which the City hopes will come from the State or federal governments.

The Mayor also proposes to allocate nearly \$29 million over the next five years to ensure that all classrooms have air conditioning by 2022. In addition, the budget aims to provide \$10 million for supportive services for homeless students in FY 2018. The Independent Budget Office reports that there were 32,803 students living in shelters in the 2015-16 school year.

Each year, the Department of Education submits Medicaid reimbursement claims for eligible services provided to special education students. However, the department has historically had difficulty substantiating such claims to the federal government.

The department hired a consultant to improve the claiming process, but the computer system used to document claims also has encountered problems. The City plans to spend an additional \$97 million during the financial plan period (nearly \$16 million in FY 2017 and about \$20 million annually over the next four years) to address the shortcomings. The department is making several other improvements to increase the likelihood of receiving Medicaid reimbursements.

Last year, the department submitted claims totaling \$18 million, \$79 million less than the target at the beginning of the fiscal year. The April Plan assumes that the amount of Medicaid reimbursement will more than double to \$41 million in FY 2017 and will reach \$97 million annually beginning in FY 2018. (The City had received less than \$8 million in Medicaid reimbursements as of May 11, 2017.)

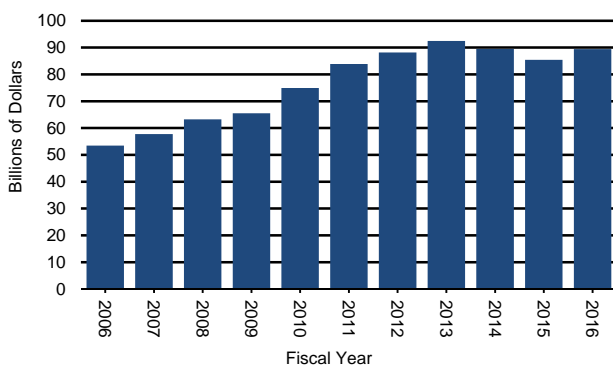
Until the department can demonstrate the ability to adequately document such claims, it remains uncertain whether the City can increase reimbursements above last year's level, putting \$23 million in FY 2017 and \$79 million annually thereafter at risk.

X. Other Issues

1. Post-Employment Benefits

The City's unfunded liability for post-employment benefits other than pensions (OPEBs) increased by \$3.9 billion to \$89.4 billion in FY 2016, the first increase since FY 2013 (see Figure 27). The increase is driven mostly by revised mortality tables that reflect longer life expectancies.

FIGURE 27
Unfunded OPEB Liability



Sources: NYC Actuary; OSC analysis

In 2015, the Governmental Accounting Standards Board approved two rules (which take effect in FY 2018) that could increase the City's OPEB liability. For example, entities that do not fund their OPEB liabilities on an actuarial basis could be required to discount future costs using an interest rate that is lower than the assumed rate of return on investments, which would increase the unfunded liability.

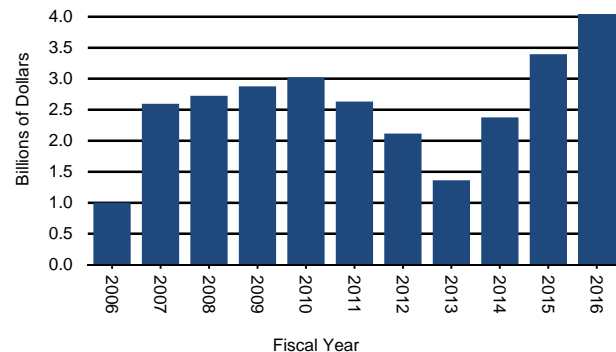
The City, like many employers, does not fund its OPEB liabilities on an actuarial basis but rather pays the annual cost of benefits to current retirees on a pay-as-you-go (PAYGO) basis. OPEB costs, on a PAYGO basis, are projected to rise from nearly \$2.2 billion in FY 2016 to \$2.9 billion in FY 2021, an increase of nearly 34 percent over five years.

2. Retiree Health Benefits Trust

In FY 2006, the City established the Retiree Health Benefits Trust (RHBT) to help fund the future cost of OPEBs. During fiscal years 2006 and 2007, the City deposited \$2.5 billion of surplus resources into the RHBT. These resources were invested and earned interest, with the balance exceeding \$3 billion by FY 2010.

While the RHBT was intended to help fund future OPEB liabilities, it has been used as a rainy-day fund. The City drew down much of the resources in the RHBT during fiscal years 2011 through 2013 as it managed through the Great Recession (see Figure 28). Over the past three years, the City rescinded a planned drawdown of \$1 billion and contributed \$2.3 billion to the RHBT (a total financial benefit of \$3.3 billion), raising the RHBT balance to \$4 billion, the highest amount ever.

FIGURE 28
RHBT Year-End Balance



Note: Adjusted for prepayments in fiscal years 2008 and 2009.
Sources: NYC Comptroller; NYC Office of Management and Budget; OSC analysis

3. Prior Years' Expenses

At the end of each fiscal year, the City estimates the amount of expenses that have been incurred but not yet paid, and the amount of revenues earned but not yet received. The City generally makes conservative estimates because an unfunded liability has a budgetary impact in the current fiscal year.

Over the past 10 years, the City has realized an average benefit of \$459 million annually from overestimating prior years' expenses and from underestimating prior years' receivables. In FY 2016, the City realized a net benefit of \$322 million, largely from an overestimation of prior-year expenses in the Department of Education. The April Plan anticipates savings of \$400 million in FY 2017, but none in subsequent years.

4. Reserve for Disallowances

The City maintains a reserve for disallowances of federal and State aid. From fiscal years 1980 through 2005, the reserve averaged \$230 million annually, but the City began to increase the reserve in FY 2006 after federal audits found that claims for \$800 million in Medicaid reimbursement could not be fully documented. The reserve reached nearly \$1.2 billion by the end of FY 2011.

After most of the Medicaid liability had been settled, the City reduced the reserve to \$1 billion in FY 2012, based on a change in the methodology used to calculate the risk of future disallowances. Each year, the City Comptroller, in consultation with the City's independent auditor, performs a risk assessment to determine the adequacy of the reserve.

The City recently completed an assessment and found that disallowances over the past five years were lower than anticipated. Based on these results, the City reduced the reserve by \$613 million in FY 2017, leaving nearly \$498 million in the reserve. In addition, the City no longer plans to make a \$15 million contribution to the reserve in FY 2017, which will raise the financial plan benefit to \$628 million. The April Plan assumes the City will resume making an annual \$15 million contribution to the reserve starting in FY 2018.



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